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**
In the Matter of the Petition of PacifiCorp, d/b/a Pacific Power & Light Company for an Order Approving Deferral of Costs Related to Declining Hydro Generation	**DOCKET NO. UE-050412**

REPLY BRIEF ON BEHALF OF THE STAFF OF THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

March 6, 2006

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I. OVERVIEW

1 When the Commission reviews the record as a whole, it should conclude that PacifiCorp does not need rate relief. However, thoughtful Commission resolution of the important issues in this case cannot result from the limited view of the issues imparted by PacifiCorp in its opening brief.

2 For example, the Company suggests it has "suffered significant financial deterioration" by allegedly earning only 3.5 percent on equity in Washington.[1] PacifiCorp does not explain that this figure assumes the Revised Protocol is approved, along with each and every other adjustment the Company advances in this case.[2]

3 As Staff's Appendix Table 8 shows, PacifiCorp is earning a healthy 6.739 percent on rate base on an "unadjusted results" basis, and a robust 8.202 percent on rate base after Staff's ratemaking adjustments.[3]

4 PacifiCorp further complains its Standard & Poor's business position rating has "dropped" from three to five.[4] PacifiCorp does not explain that while the change from three to four was occasioned by the California energy crisis, the change from four to five had everything to do with a structural change in Standard & Poor's rating system, and had nothing whatsoever to do with a change in PacifiCorp's risk.[5]

5 PacifiCorp also observes it has the lowest rates among the three investor-owned electric utilities in Washington.[6] However, the issue is not how PacifiCorp's Washington ratepayers

[1] PacifiCorp Opening Brief at 2, ¶ 6.
[2] Exh. No. 193 at 2.2, line 67, "Adj Total" col. (Wrigley).
[3] Staff Opening Brief at Appendix page 11, first page of Table 8, columns 1 and 3, respectively.
[4] PacifiCorp Opening Brief at 2, ¶ 6.
[5] Tr. 1714:11-1715:10 (Hill).
[6] PacifiCorp Opening Brief at 2, ¶ 5, citing Exh. Nos. 764 and 765.

have fared against ratepayers of other utilities in this state. The issue is whether PacifiCorp's Washington ratepayers are paying a fair share of PacifiCorp's costs to serve them.

6 Rate comparisons do not tell a complete story. Nonetheless, despite explosive growth in Utah, rates there today are eight percent lower than before the 1989 combination of Pacific Power & Light and Utah Power & Light, while rates in Washington are 12 percent higher.[7] This is at least a hint that Washington ratepayers are paying more than a fair share of PacifiCorp's costs compared to Utah ratepayers, and Utah ratepayers are receiving a disproportionate share of merger benefits.

7 PacifiCorp goes on to say it needs to invest billions of dollars in order to properly serve its Washington ratepayers.[8] However, if PacifiCorp invests in its generation system in order to serve Washington (in a prudent and least cost way), Staff has consistently stated it will recommend rates to cover those costs.[9] Likewise, Utah, Wyoming, Idaho, California and Oregon rates should reflect the investments PacifiCorp is required to make in order to serve ratepayers there. Unfortunately, the Revised Protocol makes no attempt to determine costs based on causation, which is why Staff's control area-based cost allocation proposal would better promote the determination of rates that would recover any required investment for its Washington ratepayers.

8 It is as important as ever that the Commission consider the whole record because this case presents several critical issues. For example, the Commission must decide whether it will adopt an allocation method that permits the Commission to set fair, just, reasonable and

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[7] Exh. No. 764, last page (Staff's Supplemental Response to Bench Request No. 25 (February 10, 2006), as explained in the letter of the same date in that Exhibit).
[8] PacifiCorp Opening Brief at 4, ¶ 11.
[9] *E.g.*, Exh. No. 541TC at 56:1-3 (Buckley): "Staff is ready and willing to recommend that Washington customers pay rates that reflect the risks associated with PacifiCorp's Washington operations."

sufficient rates, or the Revised Protocol, which is designed to pass along to Washington ratepayers the costs of resources PacifiCorp has acquired to serve customers elsewhere.[10]

9 The Commission must also decide whether it will give ratepayers the benefits of lower capital costs, or whether it will accept the Company's "glass floor" arguments that use returns of other utilities to maintain above-market returns for PacifiCorp.

10 The Commission must decide whether it will approve decoupling, and guarantee PacifiCorp fixed cost recovery without any quantified ratepayer benefit, and whether it will grant a broad-ranging power cost adjustment mechanism (PCAM), to provide investors a high level of assured revenue stability, and ratepayers a high level of rate instability.

11 In the end, when the Commission considers the record as a whole, and acquires a full understanding of the issues, it will find that Staff's proposals offer a proper balance between ratepayer and investor interests, and hold PacifiCorp to its statutory burden[11] to prove a rate increase is justified.

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[10] PacifiCorp comments that the lack of a decision on cost allocations has led to "regulatory dysfunction." It cites as an example of this "dysfunction" Staff and Public Counsel's point that a PCAM cannot be implemented without an agreed cost allocation method. *PacifiCorp Opening Brief at 5, ¶ 13*.

In reply, Staff first observes that it is odd for PacifiCorp to single out Staff and Public Counsel, because the Company itself testified that a prerequisite for a PCAM is resolution of the cost allocation issue. *Exh. No. 38T at 7:14-17 and at Tr. 531:15-19 (Omohundro).* Second, from the beginning, the Company anticipated significant regulatory issues would arise as a result of the Pacific Power & Light/Utah Power & Light merger. *See, e.g., Exh. No. 8 (PacifiCorp rebuttal testimony in merger docket).* Moreover, the last PacifiCorp rate case was settled, with PacifiCorp a settling party. The Company could have insisted the allocation issue be litigated then.

Finally, we are now in the case where this issue will be resolved. Consequently, the Company's chronicle of past problems created by a lack of allocation method is interesting, but ultimately irrelevant.

[11] RCW 80.04.130(4). PacifiCorp's statutory burden necessarily includes the burden to file an appropriate results of operations based on an appropriate cost allocation method. The Company repeatedly criticizes Staff and others for not having a concrete fully functional allocation method. *E.g., PacifiCorp Opening Brief at 14, ¶ 41.* However, PacifiCorp cannot shift to Staff the Company's burden to support its case. Moreover, it is doubtful any commission staff could develop a fully-functional cost allocation method without Company resources. For example, development of the "Hybrid" model in Oregon, despite its flaws, was the direct result of an Oregon commission order that PacifiCorp develop that model.

II. INTER-JURISDICTIONAL COST ALLOCATION ISSUES

12 The opening briefs show that on the issue of inter-jurisdictional cost allocations, there is a marked difference of opinion between PacifiCorp on the one hand, and Staff and other parties on the other. The issues can also get rather technical. However, the bottom line question is: Can the Commission tell PacifiCorp's Washington ratepayers that the costs they are paying for in rates match the costs for which they should be responsible?

13 The Revised Protocol answers that question "No," as Staff has explained. In its opening brief, the Company does not directly answer that question. Rather, it implores the Commission to adopt a "uniform" cost allocation method, under threat of untoward, though unspecified consequences.[12]

14 Staff suggests that if the Commission keeps this most basic question in mind, it will be able to resolve the contested issues in this case in a fair manner. To assist the Commission in this endeavor, Staff offers a simple example.

A. A Simple Example Shows The Problems With PacifiCorp's Case On Cost Allocations

15 Staff offers a simple, fact-based example to highlight the straightforward nature of Staff's case and its underlying principles, and to contrast the positions of Staff and Company.

1. Costs need to match benefits

16 The example is the Currant Creek Project. This is a $347 million, 525 MW combined cycle combustion turbine that PacifiCorp elected to locate southwest of Provo, Utah, in the Eastern Control Area.[13] In its request for bids, PacifiCorp specified that this resource must be deliverable "to PacifiCorp's network transmission system in PacifiCorp's Eastern Control

[12] PacifiCorp Opening Brief at 4-8, ¶¶ 11-21. The Company also claims other methods are "half-baked" and further consideration is a "waste of time." *PacifiCorp Opening Brief at 13-15*, ¶¶ *39-42*. This is a disappointing tactical move on PacifiCorp's part, but Staff trusts the Commission will focus on the issues, not the hyperbole.
[13] Exh. No. 541TC at 105:18-106:12 (Buckley).

Area."[14] To everyone, including PacifiCorp's Board of Directors, its regulators, and the public, the Company justified Currant Creek exclusively in terms of satisfying Eastern Control Area needs and providing Eastern Control Area benefits.[15]

17 That does not necessarily mean Currant Creek *cannot* provide benefits to Washington and the Western Control Area, despite the significant transmission constraints that led PacifiCorp to locate this project in the East.

18 For example, to the extent transmission capability exists, Currant Creek could provide benefits by serving the Western Control Area directly, during times the Eastern Control Area does not need the resource. Or, Currant Creek could benefit the Western Control Area indirectly, by means of a power exchange agreement or similar arrangement. As an example, if PacifiCorp had Currant Creek energy it did not need to serve its Eastern Control Area customers, it could sell that energy to a purchaser for delivery in Utah, in exchange for the purchaser delivering to Washington an equivalent amount of energy needed by PacifiCorp to serve its customers here.

19 PacifiCorp's case is that a theoretical possibility of such benefits justifies the Revised Protocol "rolling-in" Currant Creek and requiring Washington ratepayers to pay for that project.

20 Staff's case is that a theoretical possibility of such benefits is not enough. In order for Washington ratepayers to pay for Currant Creek, PacifiCorp has the burden to:

1) Identify and quantify the benefits of the Currant Creek Project to Washington;

2) Show that when the Revised Protocol assigns to Washington $29.4 million of the Company's Currant Creek rate base and 8.3 percent of the project's operating expenses,[16] that this is the least cost means of providing those benefits.

21 In simple form, that is Staff's case.

[14] Exh. No. 432 at 3, 1st ¶ of PacifiCorp's 2003A RFP (Tallman).
[15] Exh. No. 541TC at 105:16-111:14 (Buckley).
[16] These are the Currant Creek costs the Revised Protocol allocates to Washington. *Exh. No. 541TC at 106:9-12 (Buckley).*

2. The Company has the capability to match costs and benefits

22 PacifiCorp is capable of doing the appropriate analysis. For example, in Cause No. U-87-1388-AT, the Company committed to provide on a continuing basis a stand-alone Pacific Power & Light pre-merger power cost study, and a Utah Power & Light stand-alone pre-merger power cost study.[17] The Company is also able to both identify and quantify the load and resource balances related to each of its two control areas, as well as the transmission constraints between control areas. The latest demonstration of this is contained in the Company's recent Integrated Resource Plan (IRP) Update, Exhibit No. 343.[18]

3. The law requires the Company to prove a project provides least cost benefits to Washington before it can be placed in rate base

23 RCW 80.04.250 requires power generating facilities to be "used and useful for service in this state" before the Commission can place that plant in rate base. As the court held in *POWER v. Utilities & Transportation Commission,*[19] "even the broadest interpretation of 'service' does not include lack of service."[20] It follows that PacifiCorp must prove actual benefits to Washington, not theoretical benefits.

24 However, the Revised Protocol simply "rolls-in" each and every new Eastside generating facility PacifiCorp has acquired, and allocates a share to Washington, without identifying or quantifying any benefits to Washington, or showing that any such benefits are least cost.[21] That is why the Company failed to justify the Revised Protocol; and that is why the Commission must reject the Revised Protocol.

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[17] Exh. No. 8 at 12:7-15 (PacifiCorp rebuttal testimony in Pacific Power & Light/Utah Power & Light merger docket).

[18] As PacifiCorp's consultant stated, PacifiCorp's IRP provides "a clear path that satisfies the needs and objectives of each state …" *Exh. No. 432, "Navigant Report" at 10, 3rd* ¶. *See also* Tr. 783:22-784:25 (Tallman).

[19] 101 Wn.2d 425, 679 P.2d 922 (1984).

[20] 101 Wn.2d at 432.

[21] The need for PacifiCorp to prove the benefits are least cost is an aspect of the prudence requirement the court approved in a later case of the same name, *POWER v. Utilities &Transp. Comm'n*, 104 Wn.2d 798, 822, 711 P.2d 319 (1985).

B. The Commission Should Refuse PacifiCorp's Invitation To "Join The Other States" And Approve The Revised Protocol

25 Advocating the need for "consensus" and a "uniform" methodology, PacifiCorp invites the Commission to "join PacifiCorp's other jurisdictions in adopting the Revised Protocol."[22] However, both as a matter of law and a fair review of the record, it is clear the Commission must refuse that invitation.

1. The law does not entitle PacifiCorp to a uniform cost allocation method

26 The Commission's statutory duty is to "regulate in the public interest, as provided in the public service laws" the rates and services of utilities such as PacifiCorp.[23] Rates must be "fair, just, reasonable and sufficient."[24] The Commission sets rates based on the value of PacifiCorp's property that is "used and useful for service in this state."[25] These statutes apply whether a utility operates in Washington alone, or in more than one jurisdiction.

27 Notably, PacifiCorp claims no statutory or constitutional right to the same cost allocation method in all jurisdictions, and we have located no statute, constitutional provision or case suggesting such a right.[26] Moreover, nothing in Title 80 RCW requires the Commission to adopt a cost allocation method because other states have approved it. And certainly nothing in Title 80 RCW remotely suggests Washington ratepayers should pay service costs that PacifiCorp incurred to serve another state, in order to reach "consensus."

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[22] PacifiCorp Opening Brief at 4, heading "A;" *see also* page 5, ¶¶ 13 & 14.
[23] RCW 80.01.040(2).
[24] RCW 80.28.010(1).
[25] RCW 80.04.250.
[26] In *Moorman Mfg. Co. v. Bair,* 437 U.S. 267 (1978), a case decided in the context of multi-state taxation of a business, the Court found no constitutional basis for requiring each taxing state to use a uniform system for calculating state income taxes, even if some duplicative taxation of the company's net income resulted. The Court noted that a business subject to income tax in several state jurisdictions has the burden to prove by "clear and cogent" evidence that a state's tax allocation method "led to a grossly distorted result." *Id. at 274 (citations omitted).*

2. Conditions imposed by other state commissions mean a "uniform" allocation methodology will not exist until at least 2015, if ever, even if the Commission approved the Revised Protocol

28 PacifiCorp correctly points out that the Revised Protocol has been accepted by the commissions of four states: Utah, Oregon, Wyoming and Idaho.[27] However, PacifiCorp fails to fully explain to the Commission what these states actually did and did not do when they accepted that method. When the Commission reviews the record on that subject, it will discover there is little evidence of a true "consensus," even among the states that have accepted the Revised Protocol.

29 First, none of the orders of the commissions accepting the Revised Protocol method stated it is "grounded in cost causation principles," as PacifiCorp tried to claim at hearing.[28] This indicates any "consensus" among these four states is a fragile one, at best.

30 Second, Idaho and Utah have expressly limited the financial impact of the Revised Protocol, even though the Revised Protocol specifically allows any commission to reject its application if it does not produce "just and reasonable results."[29]

31 The Idaho commission bars the Revised Protocol from imposing rates more than 101.67 percent of what a full "rolled-in" method produces, until March 31, 2009.[30] The Utah commission has imposed the same type of factor as Idaho, calling it the "Rate Mitigation Cap," but Utah will apply this cap for five more years than Idaho; through 2014. Utah also imposed an alternative factor called a "Rate Mitigation Premium." This means that until January 1, 2015,

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[27] PacifiCorp Opening Brief at 5, ¶ 14. *See also* Exh. No. 1T at 27:9-13 (MacRitchie).
[28] Exh. No. 5T at 13:19 (MacRitchie).
[29] Exh. No. 362 at 14:9-13 (Taylor).
[30] *In re Investigation of Inter-Jurisdictional Issues Affecting PacifiCorp, d/b/a Utah Power & Light Co.*, Case No. PAC-E-02-3, Order No. 29708 (Idaho PSC, February 28, 2005) at 6-7.

rates in Utah will be based on one of these two factors when it produces the lowest revenue requirement.[31]

32 In Exhibit No. 544C, PacifiCorp forecasts that these conditions will produce the lowest revenue requirements for several years, and PacifiCorp will lose millions of dollars for the conditions it agreed to in Utah and Idaho in order to gain "acceptance" of the Revised Protocol.[32]

33 Like the commissions in Idaho and Utah, the Oregon commission also expressly declined to give the Revised Protocol a ringing endorsement. It ruled that the Hybrid Model (a control area-based model) "should not be abandoned," and ordered PacifiCorp to file a "fully functional" version of that model for use as a comparator to the Revised Protocol, and to conduct further studies on it.[33] Utah uses a different comparator than Oregon. Utah ordered PacifiCorp to file full "rolled-in" rates as a "valid benchmark to judge the reasonableness of future rates …"[34]

34 This evidence proves: 1) none of the three largest states in which the Company operates has wholeheartedly embraced the Revised Protocol;[35] 2) the Revised Protocol should not be considered a long term allocation method;[36] and, 3) at best, the Company's quest for a "uniform" allocation method is not likely to be realized any time before these conditions expire at the end of 2014, if ever.

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[31] *In re Application of PacifiCorp for an Investigation of Inter-Jurisdictional Issues*, Docket No. 02-035-04, Report and Order (Utah PSC, December 14, 2004) at 8, ¶¶ 1-3 (rate cap and premium) and at 40 (benchmark).
[32] Exh. No. 544C (Buckley).
[33] *In re PacifiCorp Request to Initiate an Investigation of Multi-Jurisdictional Issues and Approve an Inter-Jurisdictional Cost Allocation Protocol,* in Docket UM 1050, Order No. 05-021 at 12 and at 13, ¶ 2 (Oregon PUC, January 12, 2005).
[34] *Id.*
[35] Staff also testified how these facts make the Revised Protocol unsustainable. *Exh. No. 541TC at 136:1-139:3 (Buckley).*
[36] As Mr. Buckley testified:

> If the Revised Protocol was theoretically sound and efficient to administer, there would be no need for other commissions to impose conditions, caps, or other related activities, such as requiring the development of an entirely different allocation methodology, when "approving" the Revised Protocol.

Exh. Nos. 569, 570 and 570, Response items (c) (Buckley).

35 In view of these facts, PacifiCorp's ideal of actually achieving "consensus" or "uniformity," in the sense that even the states accepting the Revised Protocol will apply it the same way, is so remote as to be illusory.

3. The Commission should take the Company's unspecified claims of harm with a "grain of salt"

36 PacifiCorp then suggests that if the Commission rejects the Revised Protocol, certain unspecified "suboptimal" decisions may result, "efficiency" may suffer in unspecified ways, and some unidentified investors may take their business elsewhere.[37] However, when the Commission evaluates these threats based on the entire record, a different story emerges.

37 For example, as we just explained, even if the Commission adopted the Revised Protocol, it would not be fully implemented until 2015, because of the conditions PacifiCorp agreed to in Idaho and Utah.[38] Even then, Idaho, Utah and Oregon have chosen comparators that make full implementation of the Revised Protocol unrealistic. Consequently, if PacifiCorp is correct that harm will come if the Revised Protocol is not fully implemented in all states, that harm will occur whether the Commission approves the Revised Protocol or not.

38 But the Commission should not assume harm will occur at all. First, no one should have a legitimate problem if Washington is properly allocated its fair share of PacifiCorp's costs. If PacifiCorp is unable to recover its total costs as a result, that means the problem lies elsewhere.

39 Moreover, the Commission should be skeptical of the Company's claims of woe. The Commission will recall that in its direct case, PacifiCorp spoke a similar message of financial

[37] PacifiCorp Opening Brief at 4-5, ¶12.
[38] *Supra* at 8-9, ¶ 31.

distress.[39] However, the market spoke a different message. Within weeks of PacifiCorp filing that testimony, PacifiCorp had a deal to be bought for $1.2 billion over book value.[40]

C. The Revised Protocol Is Not Consistent With Commission Practice

40 The Company argues that the Revised Protocol is "consistent with historic Commission practices."[41] To bolster this argument, the Company refers to the non-scientific sample Mr. Taylor did of a few electric utilities, which PacifiCorp now calls a "national survey."[42] At hearing, however, PacifiCorp's argument was shown to be overstated.

41 Indeed, the relevant questions are whether any of the surveyed utilities have any transmission constraints between jurisdictions, or whether any of them were built by merging utilities with different cost structures. PacifiCorp's "survey" never asked those questions.[43] As a result, no valid comparisons can be made.

42 However, there is relevant information in the record regarding what the Commission does when it is faced with an issue where a utility's costs diverge in certain areas. The record shows that the Commission considers separate cost or rate structures to protect ratepayers in the lower cost area.

43 For example, when Avista Corp. (the lower cost utility) sought to merge with Sierra Pacific Resources (the higher cost utility), the Commission rejected setting rates on a "rolled-in" basis, stating that the combined operations of the two companies would "not be reflected in

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[39] Exh. No. 1T at 4:29-30 (MacRitchie).
[40] Tr. 344:18-22 (MacRitchie).
[41] PacifiCorp Opening Brief at 12, ¶ 34. At hearing, the Company also said a fully "rolled-in" allocation method was consistent with the NARUC Cost Allocation Manual. However, the Company conceded that the NARUC Manual provides only general guidance; it does not specify what to do when a utility operates in two separate control areas with limited transfer capability between them. *Tr. 711:21-712:1 (Taylor).*
[42] PacifiCorp Opening Brief at 12, ¶ 34.
[43] Tr. 712:11-17 (Taylor).

Washington results of operations for any purpose."[44] In later testimony before the FERC, the Commission informed FERC that the Stipulation approved in Washington recognized the two companies would be operated as separate divisions after the merger, and that power exchanges between them would be transacted at market prices.[45]

44 Another example occurred in Cause No. U-83-14, where the Commission refused to require Washington ratepayers pay a share of the excess costs associated with Avista's contract with Potlatch Corp. (the service was provided in Idaho).[46] Yet another example is found in the "area rates" established by Puget Sound Energy Co. (PSE) in Kittitas County, which reflect PSE's higher costs to serve in that area.[47]

45 These examples fully support continuing the Commission's policy of focusing on the costs to serve a specific area, if the utility's costs to serve are materially different. Staff's proposal to use a control area-based allocation method is consistent with this policy. The Revised Protocol is not.

D. The Revised Protocol Is Fundamentally Unsound

46 In Staff's opening brief, we demonstrated that the Revised Protocol is fundamentally unsound because it is designed to avoid cost shifts and pursue "acceptable" results, it is inappropriately "results-driven," and the studies PacifiCorp uses to support the method are inappropriate and unreliable.[48]

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[44] *In re Application of Washington Water Power Co.*, Docket Nos. UE-941053 and UE-941054, 9th Supp. Order at 7 (December 6, 1995). The Commission's order is contained in Exh. No. 579, beginning at page 59.
[45] Exh. No. 579 at 15 (Buckley).
[46] *See* Exh. No. 577 at 1, Response 3rd ¶ (Buckley). Note the reference to Cause No. U-83-13 should be U-83-14.
[47] Exh. No. 577 at 2 (Buckley).
[48] Staff Opening Brief at 7-12, ¶¶ 25-45.

47 PacifiCorp tries to defend the fact that the Revised Protocol is founded on "results-driven" analyses. According to PacifiCorp, Staff is "far out of the mainstream," and "extraordinarily naive" to believe consensus could be reached without this approach.[49]

48 On the contrary, Staff's principled focus on a cost causation approach to determining the appropriate allocation methodology is not "out of the mainstream" at all. In fact, Staff's approach is consistent with the statutory "used and useful" statute, as we discussed above.[50] It was most of the other MSP parties who strayed from the mainstream principle that allocations should reflect cost causation. It was they who endeavored instead to address goals and "agendas" specific to their particular state.[51] This is also evidenced by the imposition of various conditions and revenue requirement caps in the orders accepting the Revised Protocol.

49 Finally, Staff has not suggested, as the Company claims, that cost allocation impacts have no role in choosing an appropriate allocation methodology. Staff only suggests that a results-driven approach should not be the determining factor, as it was here.[52]

E. The Revised Protocol Allocates Resources To Washington Ratepayers That They Did Not Cause PacifiCorp to Acquire

50 In Staff's opening brief, we demonstrated how the Revised Protocol's fundamental feature of "rolling-in" all resources and then allocating a share to all states makes Washington ratepayers responsible for resources they did not cause the Company to acquire.[53] In that analysis, Staff provided evidence from the Company's own documents showing it was Utah and

[49] PacifiCorp Opening Brief at 7, ¶ 20.
[50] *Supra* at 6, ¶ 23.
[51] Tr. 990:25-992:11 (Buckley).
[52] Tr. 967:8-12 (Buckley).
[53] Staff Opening Brief at 12-19, ¶¶ 46-65.

the Eastern Control Area that has caused PacifiCorp to acquire the Gadsby Peaker Project, the West Valley Lease, Currant Creek, and other new Eastside resources.[54]

51 Against these facts, PacifiCorp suggests that it is wrong to think that the Company is adding these new resources to satisfy Utah load growth, or that the Revised Protocol causes Washington ratepayers to "subsidize" Utah load growth. According to PacifiCorp, this is because the Company operates as a single, integrated generation and transmission system.[55]

52 In response, Staff will start by quoting the Company's direct testimony, where Mr. Duvall conceded: "It would not be practical for the Company to operate as a single control area because of the limited transmission rights between its Eastern and Western Control Areas."[56] In other words, the Company *does not* operate as a single, integrated system.

53 Staff then points the Commission again to the actual documents in the record under which PacifiCorp planned, acquired and now operates these new resources in Utah. Using these Company documents, Mr. Buckley carefully documented how at every opportunity, in its IRP, its Requests for Proposals (RFP), its Board presentations and its sworn testimony in certificate of need proceedings, the Company consistently portrayed these projects as being planned, acquired and operated to meet the needs of Utah and the Eastern Control Area only.[57] A rational allocation methodology would recognize these facts and assign costs accordingly.

1. The Revised Protocol cannot be justified given the limited degree of integration between PacifiCorp's control areas

54 The presence of significant transmission constraints between PacifiCorp's control areas proves a "rolled-in" method like the Revised Protocol makes no sense.[58]

[54] Staff Opening Brief at 14-17, ¶¶ 52-59.
[55] PacifiCorp Opening Brief at 9, ¶ 23-25.
[56] Exh. No. 331T at 5:2-4 (Duvall).
[57] Exh. No. 541TC at 74:6-118:8 and exhibits cited therein (Buckley).
[58] *E.g.*, Staff Opening Brief at 4-6, ¶¶ 16-20.

55 PacifiCorp falsely charges that Staff is arguing that PacifiCorp's system is not integrated because PacifiCorp lacks "unlimited" ability to transfer energy between control areas.[59] In fact, Staff never claimed "unlimited" transfer capability was required before a "rolled-in" cost allocation method could be appropriate. What Staff proved, based on the Company's own documents, was: 1) PacifiCorp is significantly transmission-constrained between control areas; and 2) PacifiCorp is siting major projects in Utah because it cannot transfer power there.[60]

56 Indeed, if PacifiCorp *could* transfer significant amounts of power from the West to the East, it would have kept the Centralia Steam Plant, rather than sell it and build large projects in Utah to be close to the loads requiring them.[61]

57 In any event, as we discussed before, Staff's control area-based allocation methodology provides PacifiCorp the opportunity to recover costs across control areas, but only if it can identify the corresponding benefits to this state, and demonstrate they are least cost. Notwithstanding the Company's contrary claims,[62] this includes benefits of exchanges or other non-physical transactions within and across control areas.

58 The Company offers a quote from the direct testimony of a Public Counsel witness commenting on PacifiCorp using an integrated portfolio of resources.[63] That quote is correct to the extent it applies to a single control area. As Staff demonstrated, PacifiCorp plans, acquires and operates resources based on its two control areas.[64] However, that quote is not correct if it applies across the Company's two different control areas.

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[59] PacifiCorp Opening Brief at 10, ¶ 30.
[60] *See* Staff Opening Brief at 5, ¶ 17 and accompanying footnotes.
[61] Indeed, the fact that PacifiCorp sold its share of the Centralia Power Plant in 2000, and has then proceeded to build 1400 MW of resources in Utah proves both: 1) the Company has no need for new generation resources in Washington or the Western Control Area, and 2) the Company is not well integrated between control areas. *Exh. No. 541TC at 34:17-35:4 (Buckley).*
[62] PacifiCorp Opening Brief at 11, ¶ 31.
[63] PacifiCorp Opening Brief at 9, ¶ 25, quoting Mr. Black's testimony in Exh. No. 471T at 4.
[64] Exh. No. 541TC at 56:16-118:8 and exhibits cited therein (Buckley).

2. The Commission should require that the cost allocation method reflect the realities of PacifiCorp's operations in largely separate control areas

59 A cost allocation method should reflect the way the utility plans, acquires resources, and operates its system. The Revised Protocol fails to do that.

60 Nonetheless, the Company argues that the Commission should treat PacifiCorp as a single system and to do otherwise is "improper and risky," because the Company is expected to need 300 MW of new resources.[65] This argument is just another way for PacifiCorp to turn the Commission's attention away from the fact that the Revised Protocol calls for Washington ratepayers to pay for a share of some $800 million in new resources the Company acquired in Utah to serve customers there.

61 However, if PacifiCorp can prove it truly needs 300MW of new resources to serve Washington, and it acquires those resources at least cost, then Washington ratepayers should be called upon to pay for them. Of course, the Revised Protocol method is not necessary to accomplish that. Moreover, the record does not support the need for such resources. In fact, the record shows the Company has been reluctant to provide an RFP in Washington specifically for Westside resources.[66]

F. The Revised Protocol Is Flawed In How It Works

62 In Staff's opening brief, we showed how the Revised Protocol improperly treated seasonal resources, the Mid-Columbia Contracts, QF contracts, and A&G costs.[67]

1. Seasonal Resources

63 PacifiCorp comments on the Revised Protocol's treatment of "seasonal resources," saying these resources are allocated "on a weighted basis that considers monthly state loads and

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[65] PacifiCorp Opening Brief at 11, ¶ 32.
[66] Exh. No. 541TC at 94:16-17 (Buckley).
[67] Staff Opening Brief at 19-23, ¶¶ 66-79.

monthly resource operation. In this manner, the costs of summer-peaking combustion turbines are disproportionately allocated to summer-peaking states."[68]

64 The Revised Protocol's treatment of seasonal resources fails to address Staff's concerns regarding cost causation. This is because new resource costs that are determined to be "seasonal" under the Revised Protocol, are "rolled-in" and allocated to Washington based on monthly loads, without any showing of whether: 1) Washington has an incremental need for that resource; or 2) whether that resource is the least cost option to meet Washington's actual seasonal resource requirements.

65 In other words, the Revised Protocol allocates the costs of summer-peaking combustion turbines to summer-peaking states in an unfair manner when those seasonal resource costs are also allocated to non-summer peaking states that do not require those resources, or when those resources are not the least cost means of providing benefits to non-summer-peaking states.

2. Administration and general expenses

66 In Staff's opening brief, we showed that the Revised Protocol's "SO factor" unfairly allocates A&G costs to Washington because it is too heavily weighted by existing plant. Staff proposed a "3-Factor" allocator to more properly allocate these management overheads.[69]

67 PacifiCorp asks the Commission to reject Staff's 3-Factor allocator for one reason only: because PacifiCorp thinks Staff's proposal is "based on a mistaken analysis."[70] Staff made no mistake. The Company's SO factor is subject to the whims of the allocation of plant.[71] Staff

[68] PacifiCorp Opening Brief at 7, ¶ 18.
[69] Staff Opening Brief at 21-23, ¶¶ 75-79.
[70] PacifiCorp's Opening Brief at 29, ¶ 91.
[71] Exh. No. 371-T at 22:14-15 (Taylor).

avoids this problem with the use of three different factors, each of which is a direct measure of a state's portion of the system.[72]

68 The elements with the greatest weight in the SO factor are not good indicators of current period A&G costs. For example, under the Company's SO factor, Washington's system generation factor (8.6273 percent) is nearly a full percentage point higher than its number of customers (7.6341 percent).[73] Because the Company allocates overheads based mostly on the generation factor, Washington receives a disproportionate amount of expense relative to the costs Washington imposes on the system.

69 As the most northern state in PacifiCorp's territories,[74] Washington naturally sees colder winter temperatures and eastern Washington, like the Great Basin states, observes periods of high summer temperatures. Staff's inclusion of the System Generation factor recognizes the seasonal peaks in Washington's consumption.[75] However, PacifiCorp's Washington ratepayers should not be penalized by over-emphasizing capacity in the allocation of overhead costs. Staff's 3-Factor allocator better matches current period expenses with the needs of each jurisdiction.

70 Growth in a jurisdiction is inherently caused by greater numbers of customers. Those customers need more distribution plant, more generation plant, and more corporate services. Management, perforce, must attend to those needs. Staff's 3-Factor allocator, based equally on customer counts, net distribution plant, and the system generation factor, is a balanced method of

[72] Exh. No. 631-T at 67:3-4. (Schooley)
[73] Exh. No. 193, at Tab 10:10.1 (Wrigley).
[74] Exh. No. 6 system map (MacRitchie).
[75] Exh. No. 631-T at 66:18 (Schooley).

sharing corporate overheads.[76] The A&G allocator in the Revised Protocol does not fairly allocate these overheads.

G. The Solution Is For The Commission To Require The Use Of A Simplified Control Area-Based Model, Though The Commission May Use Staff's "Amended Revised Protocol" To Set Rates In This Case

71 In Staff's opening brief, we explained why the proper course of action at this point is for the Commission to require the Company to work with Staff and other Washington parties to develop a control area-based cost allocation model.[77] In the meantime, Staff offered its Amended Revised Protocol as a way for the Commission to set rates in this case.[78]

72 The Company's attitude is that each cost allocation methodology proposed by another party in this case is "half-baked," "unworkable," and "wasting everyone's time."[79] This is truly unfortunate. Staff was marginalized, if not rebuked, in this way throughout the MSP process, and it is not productive.[80] Nonetheless, Staff remains resolute in its desire to work with the Company to develop an appropriate methodology for Washington.

73 However, PacifiCorp's brief makes it crystal clear that a very direct and specific order from the Commission will be required to address this attitude of the utility.[81]

74 PacifiCorp goes on to unfairly challenge Staff's proposed Amended Revised Protocol as being "patently one-sided." The Company continues to claim, incorrectly, that Staff is "picking

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[76] Staff Opening Brief at 22, ¶ 77.
[77] Staff Opening Brief at 24-25, ¶¶ 83-88.
[78] Staff Opening Brief at 25-27, ¶¶ 89-91.
[79] PacifiCorp Opening Brief at 13-14, ¶ 39.
[80] *See* Staff Opening Brief at 9-10, ¶¶ 33-34, and footnote 46 (and Exh. No. 567 referred to therein).
[81] Perhaps PacifiCorp's unfortunate comments signal that it is preferable to require an alternative to the simplified control area-based allocation model Staff primarily supports. Staff could support a Commission order to the Company to develop the Full Requirements Contract Model suggested in the direct testimony of Mr. Buckley. *See Exh. No. 541TC at 148:17-151:9.* This alternative may provide the best balance between jurisdictional efficiency and the needs of the Company, perhaps expanding on the concept of more performance-based rates for Washington. Such a model may be a more appropriate, and possibly timelier, solution than a simplified control area-based allocation model.

and choosing" amongst the Company's resources to "selectively exclude costs."[82] These claims are completely unfounded.

75 Staff clearly described why and how the proposed Amended Revised Protocol's adjustments were implemented in an attempt to allow the Company to support rates in this proceeding.[83] The Company apparently does not recognize that Staff's transitional allocation method continues to allocate significant variable and fuel costs related to the resources the Company now chastises Staff for continuing to include, and it includes other Eastside resources as well.[84]

76 While Staff recognizes it did not change the generation dispatch, the point of the New Eastside Resource Adjustment was simply to approximate a "transfer price," based on the generous, unproven assumption these new Utah projects provided some benefit to Washington.[85]

77 The Company also argues Staff's Amended Revised Protocol claims for Washington "an even larger share" of Mid-Columbia benefits, and an even lower share of QF contract costs, than what was available under the "Modified Accord" method.[86] Of course, this is not a valid comparison at all, because the Commission never adopted the Modified Accord method.

III. OTHER COST RECOVERY ISSUES

A. PCAM

78 In Staff's opening brief, we explained that while PacifiCorp's PCAM proposal was extreme, Staff can support a reasonably-crafted PCAM, once a cost allocation method is established.[87]

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[82] PacifiCorp Opening Brief at 15, ¶ 43.
[83] *E.g.*, Exh. No 541TC at 159:16-162:13 (Buckley).
[84] *E.g.*, Exh. No. 541TC at 164:7-165:2 and at 175:10-177:9 (Buckley).
[85] Staff Opening Brief at 27, ¶ 91.
[86] PacifiCorp Opening Brief at 15, ¶ 43.
[87] Staff Opening Brief at 27-30, ¶¶ 93-100.

1. It is premature to approve the Company's PCAM filing

79 PacifiCorp observes that it is the only investor-owned electric utility in Washington that does not have a power cost mechanism.[88] However, this fact alone is not sufficient for the Commission to approve the Company's PCAM, as filed. Staff has repeatedly made it clear to the Company that it would support an appropriately-designed power cost mechanism once the inter-jurisdictional cost allocation issues are resolved.

80 The resolution of cost allocation issues is fundamental to the Commission's ability to not only establish reasonable base costs for serving Washington, but also for guidance on what costs and resources should be included in any power cost adjustment mechanism that is approved.

2. The Company's PCAM proposal does not appropriately share the risk in variations in power costs

81 The Company claims that its PCAM proposal is incentive-based and the Company would share in the variations of net power costs.[89] This apparently refers to the Company's "90:10" proposal, whereby customers are responsible for 90 percent of the variation in net power costs, while the Company absorbs 10 percent. The Company goes on to say that this proposal is similar to Avista's Energy Recovery Mechanism (ERM).[90]

82 The Company apparently has overlooked the significant "deadband" feature contained in Avista's ERM – currently it is plus/minus $9 million.[91] PacifiCorp's PCAM proposal contains no such feature, so it is in no way comparable to Avista's as far as risk sharing is concerned.

83 In his direct testimony, Mr. Buckley articulated the importance of a "deadband" in designing a power cost adjustment mechanism for the Company,[92] but the Company has refused

[88] PacifiCorp Opening Brief at 15, ¶ 44.
[89] PacifiCorp Opening Brief at 15-16, ¶ 45.
[90] PacifiCorp Opening Brief at 16, ¶ 44.
[91] PSE's mechanism also has a significant deadband.
[92] Exh. No. 541TC at 194 (Buckley).

to alter its proposal.

84 Interestingly, the Company recently entered into a Stipulation in Wyoming that calls for a PCAM with a "deadband" of $40 million; from $40 million to $100 million, the Company absorbs 30 percent; from $100 million to $200 million, the Company absorbs 15 percent; and above $200 million, the Company absorbs 10 percent (all figures are total company).[93]

85 The Company's PCAM proposal in this state is plainly insufficient.

3. Resolution of cost allocation issues is vital to the design of a power cost adjustment mechanism for PacifiCorp

86 PacifiCorp now advocates that cost allocation issues should not be an impediment to having a PCAM.[94] This contradicts the Company's testimony at hearing, where it acknowledged that a cost allocation method was a prerequisite to having a PCAM.[95] Nonetheless, the Company's advocacy is not surprising, given that the Company's proposal calls for Washington ratepayers to pay for variations related to net power costs in *both* control areas.

87 In any event, the Company's testimony should trump its advocacy on this point. As we stated above, the resolution of cost allocation issues is fundamental to the Commission's ability to not only establish reasonable base costs for serving this state, but also for guidance on what costs and resources should be included in any power cost adjustment mechanism.

4. The Company mischaracterizes Staff's arguments regarding the PCAM and normalized power costs

88 The Company claims Mr. Buckley contends that normalization methods used in setting net power costs in rate cases will make the Company whole in the long run, and that this

[93] *In re Application of PacifiCorp to Increase its Retail Electric Service Rates*, Docket No. 20000-230-ER-05 (Wyoming PSC), Stipulation and Agreement at 7, ¶ 18 (filed February 2, 2006).
[94] PacifiCorp Opening Brief at 17-18, ¶ 52.
[95] Exh. No. 38T at 7:14-17 and at Tr. 531:15-19 (Omohundro).

perspective turns a "blind eye" to the asymmetric nature of power cost variability.[96] However, the Company's characterization is misleading. Mr. Buckley simply and clearly stated that the normalization technique of determining net power costs has a built-in mechanism to capture "*most* variations in power supply costs over the long-term."[97]

89 This is categorically different than Staff believing the normalization process ensures recovery of *all* cost variations, as the Company claims. In addition, the Company's claim that Staff turns a blind eye toward the asymmetry of net power costs ignores that fact that the use of appropriate market and fuel price forecasts in the normalization process addresses the asymmetry issue.

B. Hydro Deferral Petition

90 In Staff's opening brief, we explained that while PacifiCorp's request for 100 percent recovery of $8.26 million in deferred hydro costs is unbalanced and inappropriate, recovery of $2.1 million in such deferred costs can be justified.[98]

91 The Company confirms it is requesting 100 percent rate recovery of drought-related excess power costs, while offering no sharing mechanism. Moreover, the $8.3 million PacifiCorp is requesting is based on allocating excess power costs to Washington under the Revised Protocol.[99]

92 Consequently, in addition to passing 100 percent of the risk of drought to ratepayers, the Company's proposal also means Washington ratepayers are being asked to pay not only for costs related to the drought on the Westside of PacifiCorp's system, but also costs related to drought based on Eastside water conditions.

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[96] PacifiCorp Opening Brief at 18, ¶ 55.
[97] Exh. No. 541TC at 189:14-17 (Buckley)(emphasis added).
[98] Staff Opening Brief at 30-32, ¶¶ 101-107.
[99] PacifiCorp Opening Brief at 19, ¶ 56.

93 This is patently unfair and inappropriate. By contrast, Staff's adjustments to the Company's calculation are appropriate and reasonable.[100] Staff removes the effects of Eastside water conditions, and establishes a "deadband." This risk-sharing mechanism limits the recovery from ratepayers of excess power costs to those amounts that are determined to be "extraordinary."

94 Staff's water-year adjustment (eliminating extreme good and bad water years) adopted in the previous rate case for purposes of determining normalized net power costs, is unrelated to the band proposed by Staff as a risk sharing mechanism in determining the appropriate amount of 2004/2005 drought-related excess power costs to be ultimately recovered. Under both the Company's and Staff's methodologies, the effects on hydro-generation of actual extreme good or bad water conditions compared to normalized amounts are clearly captured. The band proposed by Staff is nothing more than a mechanism to share that risk between Company and ratepayer.

95 The Company argues Staff double-counted here,[101] and while the Company correctly quotes what Mr. Buckley stated at hearing, Staff explained in its opening brief why, upon further reflection, there is no double counting.[102]

96 The Company's hydro deferral rate request is excessive, one-sided and unfair. Staff's proposal is balanced and well-conceived. The Commission should allow PacifiCorp to defer and recover $2,103,823 over three years as proposed by Staff.[103]

[100] Exh. No. 541TC at 210:8-213:18 and Exh. No. 557 (Buckley).
[101] PacifiCorp Opening Brief at 19, ¶56, last sentence.
[102] Staff Opening Brief at 31-32, ¶¶ 105-106.
[103] Exh. No. 541TC at 214:8-18 (Buckley).

C. Decoupling

97 In Staff's opening brief, we explained that decoupling should not be allowed because while it guarantees fixed cost recovery for PacifiCorp, it offers no quantified, tangible benefits for ratepayers.[104]

98 In their opening briefs, both PacifiCorp and NRDC continue to encourage the Commission to adopt their decoupling proposal.[105] However, nothing has changed: the decoupling proposal continues to be one-sided, with guaranteed, tangible benefits for the Company only (*e.g.*, guaranteed fixed cost recovery). The only thing guaranteed for ratepayers is increased bill volatility as a result of annual rate true-ups.

99 NRDC argues that this pilot proposal "is a prudent way to test a promising strategy for removing barriers to cost-effective conservation."[106] The implication is that there is a cause and effect relationship between decoupling and conservation along the lines of "if you build it, they will come."

100 However, there is no organic connection between the two. Conservation takes a commitment, followed by planning, effort and execution. The Commission should not rely on a benefit in theory for ratepayers to compensate them for increased bill volatility. The decoupling proposal should be denied.

IV. RATE OF RETURN

101 Staff's fact-based, market-based rate of return analysis stands in stark contrast to the Company's efforts to distance itself from what the market is saying: the cost of capital is declining. For the reasons stated below, the Commission should look to the evidence, not the numbers from other orders, or other rationalizations that distract from a proper analysis of

[104] Staff Opening Brief at 32-34, ¶¶ 108-113.
[105] PacifiCorp Opening Brief at 63, ¶¶ 187-190; NRDC Opening Brief at 1-9.
[106] NRDC Opening Brief at 2.

PacifiCorp's cost of capital. When it does that, the Commission should accept Staff's fair rate of return calculation.[107]

A. Rate of Return Before MEHC's Acquisition of PacifiCorp

102 The contested issues remain capital structure and cost of common equity.

1. Capital Structure

103 The Company takes issue with Staff's positions on: a) the inclusion of short-term debt in the capital structure; and b) the Company's desire to increase the 43.5 percent common equity ratio it has been using, to 49.5 percent.

a. The ratemaking capital structure should include short-term debt because that is how a prudent utility manager would choose to finance the utility's investment in rate base

104 The issue before the Commission is what mix of capital should be used by PacifiCorp to finance its rate base. Staff argues the Commission should include the lowest cost source of funds the Company regularly accesses to fund total utility operations: short-term debt.[108]

105 The Company concedes the Commission's normal practice is to include short-term debt in the ratemaking capital structure.[109] However, the Company argues that to avoid "double counting," only permanent sources of capital should be included, and therefore this cheapest form of capital must be excluded.[110]

106 The Company's "double counting" argument is based on the happenstance that CWIP balances have been higher than short-term debt balances.[111] Under this theory, there would be a positive correlation between all sources of capital on the liability side of the balance sheet and the permanent assets in rate base. However, utility managers do not manage capital structures

[107] *See* Staff Opening Brief Appendix at 5, Table 3.
[108] Staff Opening Brief at 36-38, ¶¶ 122-124.
[109] PacifiCorp Opening Brief at 40, ¶ 125.
[110] PacifiCorp Opening Brief at 39, ¶ 121.
[111] PacifiCorp Opening Brief at 39, ¶ 121.

based upon the specific facilities and projects within their operations. They manage the capital structure to produce the lowest overall cost of capital. Short-term debt should be included for that reason.

107 This does not mean, as PacifiCorp claims, that the Commission would be "allocating credit for the same capital twice:" once related to AFUDC; and once in calculating the return on rate base.[112] Even if we ignore the fact that the Company is not following Commission orders on how to accrue AFUDC,[113] the proper mix of capital that is appropriate in determining the fair rate of return to apply to rate base is a separate consideration from what AFUDC rate to use.

108 Prudent utility managers should finance rate base with all reasonable forms of capital, including the least expensive: short-term debt. Consequently, the Commission should include 4.0 percent short-term debt in the capital structure for ratemaking purposes.

b. PacifiCorp cites no case that supports its theory for excluding short-term debt

109 PacifiCorp supports its argument for excluding short-term debt by insisting that "other regulators" recognize that "if CWIP is excluded in rate base, short-term debt also must be excluded."[114] The only "other regulators" the Company identifies are the five commissions in the other states where PacifiCorp operates.[115]

110 An unsuspecting reader of PacifiCorp's brief might conclude that the five commission orders PacifiCorp cites actually resolved the short-term debt issue, and did so on the basis that CWIP was excluded from rate base. That reader would be grossly mistaken.

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[112] PacifiCorp Opening Brief at 39, ¶ 121 and at 40 ¶ 123.
[113] Staff Opening Brief at 37, ¶ 124 & footnote 188. The Company complains that using different AFUDC rates would be problematic. *PacifiCorp Opening Brief at 39, ¶ 122*. However, the proper forum for raising those complaints is by a PacifiCorp petition to change the Commission-required method for accruing AFUDC, not in a rate case such as this.
[114] PacifiCorp Opening Brief at 40, ¶ 124.
[115] PacifiCorp Opening Brief at 40, footnote 17.

111 Indeed, when the Commission reads the orders PacifiCorp cites,[116] it will discover that all five commissions accepted settlements. The Commission will also discover the Idaho commission order and stipulation, and the Wyoming stipulation, do not even refer to a capital structure, CWIP, AFUDC, or short-term debt. The Commission will also find that none of the orders and stipulations relied on by PacifiCorp refer to, cite, discuss or make findings on the short-term debt/CWIP/AFUDC issue PacifiCorp has injected into this case.[117] Finally, the Commission will note that by citing the California order as precedent, PacifiCorp apparently is violating a term of the California settlement that expressly prohibits such a citation.[118]

112 In short, the Company's argument in ¶ 124 of its opening brief is utterly without substance.

c. The Commission should not accept the Company's very high equity ratio because it is not economical

113 The Company attempts to defend its proposed capital structure by: 1) alleging that it is consistent with the ratios of utilities comparable to PacifiCorp; 2) suggesting that it is designed to maintain continuance of the A- credit rating; and 3) misrepresenting Staff's capital structure as not being based on the actual capital structure of PacifiCorp.[119]

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[116] The Wyoming commission has not yet issued a written order. It issued a "bench decision" on February 10, 2006, and according to practice, will soon issue a written order approving the rate case settlement. Consequently, Staff reviewed a "Stipulation and Agreement" filed February 2, 2006 in *In re Application of PacifiCorp to Increase its Retail Electric Service Rates*, Docket No. 200000-230-ER-05 (Wyoming PSC). Staff assumed this agreement is what the Wyoming Commission approved in its bench decision.

[117] *In re Application of PacifiCorp d/b/a Utah Power & Light Co., for Authority to Increase Its Rates for Electric Service* Case No. PAC-E-05-1, Order No. 29833, (Idaho PUC)(July 22, 2005); *In re Pacific Power and Light, d/b/a PacifiCorp, Request for a General Rate Increase,* Docket No. UE 170, Order No. 05-1050 (Or. PUC)(September 28, 2005); *In re Application of PacifiCorp for an Order Authorizing an Immediate Interim Rate Increase, et al.,* Docket No. U-901-E, Decision 03-11-019 (Cal. PUC) (November 13, 2003); *In re Application of PacifiCorp for Approval of its Proposed Electric Service Schedules*, Docket No. 04-035-42, Order at 10 (Utah PSC)(February 25, 2005) (the Utah case involved a partial settlement that included capital structure).

[118] Paragraph 15 of the approved California settlement (appended to the order cited in the prior footnote) states: "No provision of this Settlement Agreement shall be considered precedential for purposes of any future or concurrent proceeding." PacifiCorp is apparently violating this part of the settlement by using as precedent in this case the provision of the California settlement relating to capital structure.

[119] PacifiCorp Opening Brief at 41, ¶ 128.

114 We explain in a moment why none of these Company attempts to defend its proposed capital structure are valid. But the most critical point entirely missed by the Company, not only in its opening brief, but also in its evidence, is the Commission's requirement that the ratemaking capital structure must balance safety and economy.

115 Mr. Rothschild correctly stressed the importance of this principle in his direct testimony. He explained that his recommended capital structure is not only the actual capital structure PacifiCorp used as of December 31, 2004, and the capital structure the Company maintained over the last decade during which the Company was able to maintain its investment grade bond rating, but it also "produces a reasonable overall cost of capital."[120]

116 The Company is wrong to justify its proposed capital structure by simply referring to the average capital ratios of utilities in the comparative group. As Dr. Hadaway acknowledged, those companies may have up to 30 percent unregulated activities.[121] Consequently, comparisons to the comparative group capital structures must be made more cautiously.

117 A review of Mr. Rothschild's Exhibit No. 155 shows that the companies in the comparative group have a range in common equity ratios between 58.4 percent and 37.0 percent. As Mr. Rothschild testified, when there is such a wide range of values, the median actual value of 44.9 percent is more telling than the mean.[122]

118 A median value for a group of companies is the value for the company that falls in the exact middle ranking for the group. This is statistically useful because it naturally diminishes the impact of both high and low outliers. It therefore can be a more accurate way of evaluating the group's capital ratios than simply taking an average.

[120] Exh. No. 151T at 10:1-12:15 (Rothschild).
[121] Tr. 1241:17-23 (Hadaway).
[122] Exh. No. 151T at 18:1-12 (Rothschild).

119 The record in this case also shows that the capital structure recommended by Mr. Rothschild is virtually identical to the median capital structure for companies that Standard & Poor's has given the same A- rating it gives PacifiCorp's bonds.[123]

120 Given the complete lack of any showing by the Company that its proposed very large increase in the common equity ratio would do anything but drive up the rate of return, the Company's capital structure request is unsupported.

2. Cost of common equity

a. The Commission should base its decision on the record, not on what returns may have been allowed other utilities

121 The Company contends that the cost of equity recommended by Staff and Intervenor witnesses "are below the levels allowed comparable utilities…"[124] What the Company means by "allowed" is the returns regulatory commissions allowed certain electric companies in the past. However, this is a poor and ultimately unfair yardstick for comparison, because even a most recent regulatory commission decision could be based upon evidence prepared months before.[125]

122 Long-term interest rates are a good starting point to observe changes in capital cost rates. This is because unlike the cost of equity, interest costs can be determined with precision. A review of the interest rate graph provided on page 8 of Exhibit No. 151T shows that, especially given the natural lag between the collection of financial data for a record and the rendering of a decision, a correct cost of equity recommendation in this case should be below the cost of equity that was allowed in the past. If the allowed return on equity were not lower, something would be drastically wrong.

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[123] Exh. No. 151T at 11:6-15 (Rothschild).
[124] PacifiCorp Opening Brief at 44, ¶ 138.
[125] Exh. No. 151T at 76:8-77:6.

123 Because long-term interest rates have been on downward trend for decades, allowed costs of equity should be lower today than they were in the past.

124 Moreover, if regulators follow what other regulators allowed in the past rather than actually arriving at an independent cost of equity based on the record in their own proceeding, this will create a "glass floor" when the cost of capital is declining, and a "glass ceiling" when the cost of capital is increasing.

125 In the declining capital cost rate environment that has prevailed since the early 1980s, this would be especially unfair to ratepayers. In increasing capital markets, this would be especially unfair to investors. That is why the Commission should rely on what the record shows investors require currently for compensation when they provide equity capital.

b. If the Commission is inclined to apply its recent decisions in *Avista* and *PSE*, those decisions prove PacifiCorp's requested ROE in this case is excessive

126 The Company attempts to use the Commission's recent orders in *PSE*[126] and *Avista*[127] to challenge Staff's 8.95 percent ROE estimate. The Company employed the same tactic at hearing, to call Staff's ROE "outrageously low."[128] If the Commission is inclined to use these orders in the way the Company suggests, once the Company's hyperbole is stripped away, the Commission will find they prove Staff's ROE estimate is reasonable.

127 In *PSE*, the Commission adopted a "traditional DCF approach," which, based on that record, for that utility, justified a 10.3 percent ROE.[129] If the Commission applies the "traditional" DCF method to this record, the highest ROE is 9.3 percent, a full 100 basis points

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[126] *Utilities & Transp. Comm'n v. Puget Sound Energy, Inc.,* (*PSE*), Docket Nos. UG-040640 and UE-031471 *et al.*, Order No. 6 (February 18, 2005).
[127] Exh. No. 171, *Utilities & Transp. Comm'n v. Avista Corp.* (*Avista*), Order No. 5 in Docket Nos. UE-050482 and 050483 (December 21, 2005).
[128] PacifiCorp Opening Brief at 44, ¶ 136. *See also* Exh. No. 5-T at 4:8-12 (MacRitchie).
[129] *PSE*, Order No. 6 at 32, ¶ 80. The Company conceded this fact. *Tr. 352:6-25 (MacRitchie).*

lower than for PSE,[130] and nearly 200 basis points lower than the excessive 11.125 percent ROE PacifiCorp wants. Even this 9.3 percent ROE is too high, because it is based on the use of GDP growth to determine dividend growth.[131] In sum, if the Commission applies the *PSE* decision as PacifiCorp suggests, analysis proves Staff's 8.95 percent ROE estimate is consistent with that decision.

128 There are several reasons why the *Avista* decision is inapplicable, the most obvious being that the Commission decided *Avista* under settlement review standards[132] that do not apply here. Moreover, the *Avista* Settlement Stipulation explicitly states that "no Signing Party shall be deemed to have agreed that such a Settlement Agreement is appropriate for resolving any issues in any other proceeding."[133] The Commission should enforce this provision and decline PacifiCorp's invitation to use the *Avista* settlement decision as precedent in this case.[134]

129 If the Commission decides to accept PacifiCorp's invitation, it will find that in *Avista*, the Commission's analysis was predicated on its finding "all the experts to be credible."[135] The Commission cannot make that finding here because the record proves not all experts in this case are credible. For example, Dr. Hadaway's improper use of GDP growth, and Mr. Gorman's

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[130] Tr. 353:11-22 (MacRitchie). *See also* Exh. No. 24 at 2 (group average) (Hadaway), which shows the Company's traditional DCF ROE estimate of 9.3 percent (group average).
[131] Staff Opening Brief at 40-41, ¶¶ 130-136.
[132] Exh. No. 171, *Avista*, Order No. 5 at 9-10, ¶¶ 17-21. The Avista Settlement precludes use of that Settlement against Staff in this or any other case. *See Exh. No. 171, Settlement Agreement at 9, ¶ 20.* PacifiCorp's use of the ROE in *Avista* in this case to challenge Staff's ROE is prohibited by that Agreement and the Order adopting it.
[133] Exh. No. 171, Settlement Agreement at 9, ¶ 20.
[134] PacifiCorp took offense when ICNU used the last PacifiCorp rate case settlement to show RTO costs were not included. According to the Company, ICNU was going "against the settlement." *Tr. 376:20-25 (MacRitchie).* PacifiCorp was correct. By the same token, the Company's use of the Avista settlement on ROE also goes "against the settlement" in the *Avista* case. In both situations, it is improper to use the settlement to resolve any issue in this case.

Moreover, consider the complexities that develop if a cost of equity number is taken from a settlement. If the cost of equity allowed to Avista were to be applied to PacifiCorp, does this mean that the 40 percent common equity ratio also applied to Avista should likewise be applied to PacifiCorp? If a settlement number from one proceeding is adopted, what is the purpose of going through the time and expense of developing a separate record in a subsequent case?
[135] Exh. No. 171, *Avista,* Order No. 5 at 22, ¶ 45 and at 22-23, ¶¶ 45-49.

improper use of the arithmetic mean in his risk premium analysis, renders their conclusions not credible.[136]

130 Finally, in *Avista*, when the Commission applied the settlement review standards to decide the ROE issue, it gave equal weight to each cost of equity estimation method used in that case.[137] By contrast, when the Commission addresses return on equity in contested proceedings, it gives full weight only to the DCF method as the "best and most satisfactory method."[138] If the Commission gives the full weight to DCF that is applicable in this case, a return on equity of no more that 9.0 percent is all that is justified.[139]

131 What this discussion shows is that PacifiCorp's persistent references to ROEs for other utilities, without providing a careful evaluation of the basis for those ROEs, is a capricious exercise, indeed.[140] Yet, when insightful analysis is required, PacifiCorp offers only numbers.

132 In the end, the Commission should evaluate the ROE issue on this record, for this utility. When it does, it will find Staff's 8.95 percent ROE estimate is reasonable and consistent with investor requirements in today's capital markets.

c. The Company's own evidence shows capital costs are declining, but the Company refused to acknowledge it

133 In his analysis using the traditional DCF model, Dr. Hadaway himself captured the real and substantial fact that the cost of equity has declined. As Mr. Rothschild explained, if Dr. Hadaway's traditional DCF study is adjusted to appropriately exclude GDP growth, the DCF

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136 *See* Staff Opening Brief at 40-41, ¶¶ 130-136 and at 44, ¶ 143.
137 *E.g.*, Exh. No. 171, *Avista*, Order No. 5 at 23, Table 1.
138 *Utilities & Transp. Comm'n v. Gen. Tel. Co. of the Northwest Inc.*, (*GTE*), Docket No. UT-931591, 3rd Supp. Order at 8 (December 21, 1994):

> The Commission will continue to rely on the [DCF] analysis as the best and most satisfactory method … The results of all other methods are interesting for the Commission to see as points of comparison. However, those methods are not relied upon in this order to reach a decision on rate of return.

139 Staff Opening Brief at 38-39, ¶¶ 126-129.
140 Staff suspects that in a rising capital cost environment, PacifiCorp will abandon its "look what other regulators have authorized" approach, because those ROEs will be too low, much like Dr. Hadaway abandoned certain approaches when the results were not to his liking.

cost of equity of 8.63 percent.[141] But even if this adjustment is not made, Dr. Hadaway's traditional DCF result is still 9.3 percent (average) or 9.5 percent (median),[142] well below his 11.125 percent ROE recommendation.

134 Rather than face the truth that the cost of equity to a company such as PacifiCorp is now below 9 percent, Dr. Hadaway did two things to inflate the results: 1) he altered his prior approach to the DCF model by adding the invalid GDP-based growth rate method; and 2) he presented an argument against the traditional DCF method, merely because his growth rate computation appeared to him to be low.[143]

135 Indeed, the Company explains that Dr. Hadaway rejected the traditional, or constant growth form of the DCF model merely because the growth rate he obtained through his current implementation of the model was 2 percent lower than the growth rate he obtained back in 2001.[144] However, when confronted with the details during cross-examination, Dr. Hadaway acknowledged that since 2001, earnings retention rates have dropped substantially,[145] resulting in lower growth. Any company that retains a smaller portion of its earnings is simply left with a smaller amount of earnings to be reinvested in new facilities (*i.e.*, rate base) for future growth.

136 In other words, the retention rate data for the comparative group explain why Dr. Hadaway's DCF results *should* be lower now than in 2001. DCF works. It is theoretically correct. There was no justification for Dr. Hadaway to search for new ways and new theories to justify his higher number, or otherwise to abandon the traditional DCF method.

137 In conclusion, the credible portions of the record in this case support the capital structure and cost of equity recommendations of Staff. Staff's recommendation is based on insightful

[141] Exh. No. 151T at 59:7-20 and Exh. No. 161 (Rothschild).
[142] Exh. No. 24 at 2, col. 14, last two lines (Hadaway).
[143] Exh. No. 26T at 11:3-15 (Hadaway).
[144] PacifiCorp Opening Brief at 47, ¶ 144.
[145] Tr. 1185:11-1191:7 (Hadaway).

analysis, not new approaches designed to match perceptions of what is a "correct" result. The Commission should find that the cost of equity for PacifiCorp is 8.95 percent.

B. Rate Of Return After MEHC's Acquisition Of PacifiCorp

138 In Staff's opening brief, we addressed all of the arguments PacifiCorp raises against Staff's double leverage adjustment and the balance sheet analysis supporting Staff's adjustment. We use this reply brief to emphasize the core weaknesses of the Company's position, and its attempts to confuse the record and the Commission.

1. Staff's double leverage adjustment meets sound principles of finance that recognize the parent-subsidiary relationship between MEHC and PacifiCorp

139 PacifiCorp argues that Staff's double leverage adjustment violates threshold principles of finance.[146] This argument assumes fundamentally that the Company will be a stand-alone, publicly-held utility subject to the impersonal forces of the financial markets.

140 Reality, of course, will be far different. PacifiCorp will not be a stand-alone, publicly-traded utility. It will be a cog in the holding company wheel of MEHC, which will have complete control over the Company's capital structure. As Staff's balance sheet analysis proves, MEHC will also issue $1.7 billion of debt to finance its equity investment in PacifiCorp, but it will not actually place a corresponding amount of equity at risk in the capital markets. Then, without a double leverage adjustment, MEHC will recover from PacifiCorp's ratepayers equity costs and the cost of associated income taxes that MEHC does not actually incur. Those revenues will allow MEHC's shareholders to recover through excessive returns the premium paid by MEHC to acquire PacifiCorp.

[146] PacifiCorp Opening Brief at 57, ¶¶ 177-180. The Company cites Dr. Roger A. Morin for support. *Id. at* ¶ *176*. Dr. Morin's view has been rejected by many courts, commissions and other scholars that have adopted double leverage adjustments to reflect the true cost of capital to a subsidiary utility. *Staff Opening Brief at 48-49,* ¶¶ *153-55*.

141 The Company argues that Staff's double leverage adjustment violates the "law of one price" citing a calculation of Dr. Vander Weide.[147] However, when asked to support his calculation with qualitative analysis, Dr. Vander Weide produced only more mathematics.[148] Even then, he assumed incorrectly that the cost of equity increases proportionally to the increase in leverage in order to hold the overall cost of capital before and after the acquisition constant.[149]

142 PacifiCorp asserts that Mr. Elgin could not explain why the Commission should not analyze how each investor in other Washington utilities finances its stock purchase.[150] The Company again ignores the parent-subsidiary relationship. MEHC is purchasing the entire utility operations of PacifiCorp and will control PacifiCorp's capital structure. By contrast, an individual investor buys only a limited number of utility shares and cannot control the financial structure of the utility.[151]

143 Moreover, MEHC's use of debt to acquire PacifiCorp's equity limits MEHC's risk to the amount of equity capital committed. By contrast, an individual investor's use of margin debt to purchase a share of common stock places the investor's entire equity position at risk. These are critical distinctions that PacifiCorp does not address.

144 The Company argues that Staff incorrectly ascribes to a utility the risks of the parent's other businesses.[152] This argument confuses the clear division between a utility's initial decision to invest in a project and its subsequent decision to finance that investment at the lowest cost of

[147] PacifiCorp Opening Brief at 57, ¶ 177.
[148] Exh. No. 815.
[149] *Id.*
[150] PacifiCorp Opening Brief at 58, ¶ 178.
[151] Staff Opening Brief at 51, ¶ 158; Tr. 1583:17-1588:3 (Elgin).
[152] PacifiCorp Opening Brief at 58, ¶ 179.

capital.[153] The argument also diverts from ratepayers the benefits of diversification, in violation of fundamental principles of finance and Commission precedent.[154]

145 PacifiCorp asserts that Mr. Elgin could not explain why the Commission should not require PSE and Avista to set up double-leveraged holding companies, if double leverage lowers a utility's required rate of return.[155] The Company did not address whether the Commission has legal authority to require such action. The Company also did not explain why the Commission should diverge from established practice not to micro-manage utilities.[156] By contrast, PacifiCorp has presented the Commission with a specific double-leveraged holding company scenario. Staff's adjustment merely reflects the cost of funds that support MEHC's actual investment in PacifiCorp in that proposed transaction.

2. Staff's double leverage adjustment is supported by the factual record

146 PacifiCorp asserts that Staff's double leverage adjustment rests on "factual quicksand."[157] The Company's interpretation of the facts is incomplete and inaccurate.

147 PacifiCorp uses Exhibit No. 810-A in an attempt to show that MEHC will earn a lower return on equity than that allowed PacifiCorp.[158] However, that exhibit incorrectly states that PacifiCorp's book equity is $3.4 billion, when PacifiCorp's book equity at closing is estimated at $3.9 billion.[159] The exhibit also incorrectly uses 8.95 percent for the return on equity, when MEHC could expect to earn 11 percent on book equity with the acquisition of PacifiCorp.[160]

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[153] Exh. No. 791T at 37:6-10 (Elgin).
[154] *Utilities & Transp. Comm'n v. Pacific Power & Light Co.*, Cause No. U-84-65, 4th Supp. Order at 16 (June 7, 1985); Tr. 1560:15-1561:11 (Elgin).
[155] PacifiCorp Opening Brief at 58, ¶ 180.
[156] 1 L. Goodman, *The Process of Ratemaking* at 134 (1998).
[157] PacifiCorp Opening Brief at 59, ¶ 181.
[158] PacifiCorp Opening Brief at 59, ¶ 181(a).
[159] Exh. No. 791T at 11:5-6 (Elgin).
[160] Tr. 1509:12-1510:2, 1513:10-1514:2, and 1555:7-21 (Elgin).

Correcting these errors results in a 14 percent return on equity for MEHC after the acquisition, not the 7.07 percent return alleged by PacifiCorp.[161]

148 Relying on Exhibit No. 810-B, the Company argues that MEHC has not provided any of PacifiCorp's capital.[162] Exhibit No. 810-B is irrelevant because it excludes the acquisition premium and the income tax impact of the debt issued by the holding company to finance the purchase.[163]

149 Mr. Elgin relied upon MEHC's consolidated capital ratios to conclude that MEHC is highly leveraged with 79 percent debt.[164] The Company argues that he erred by not treating Berkshire Hathaway's subordinated debt as equity consistent with rating agency treatment, and by including subsidiary debt that is unavailable to MEHC to buy stock of other utilities.[165] According to PacifiCorp, Mr. Elgin should have used MEHC's stand-alone capital structure, which would have resulted in a 57 percent debt ratio.

150 The consolidated capital structure of MEHC is the relevant guideline since it shows how MEHC finances its entire portfolio of assets, which will include PacifiCorp once the transaction closes. The subordinated debt of Berkshire Hathaway appears on MEHC's balance sheet as debt, irrespective of rating agency treatment.[166] Debt issued by MEHC's subsidiaries also appears as debt on MEHC's consolidated balance sheet.[167]

151 The Company claims that Mr. Elgin admitted in the MEHC acquisition case that ring-fencing can substitute for double leverage treatment.[168] In fact, Mr. Elgin stated only that ring-

[161] Exh. No. 791T at 19:4 and Exh. No. 797 at 1:23 (Elgin).
[162] PacifiCorp Opening Brief at 59, ¶ 181(b).
[163] Tr. 1530:12-1531:8, 1533:15-25, 1538:17-21 and 1543:6-10 (Elgin).
[164] Exh. No. 796 (Elgin).
[165] PacifiCorp Opening Brief at 60, ¶ 181(c).
[166] Exh. No. 791T at 13:14-17; Exh. No. 795 at 1; and Exh. No. 796 at 1:10 (Elgin).
[167] Exh. No. 791T at 13:14-17; Exh. No. 795 at 1; Exh. No. 796 at 1:11; and Tr. 1547:19-1548:9 (Elgin).
[168] PacifiCorp Opening Brief at 60, ¶ 181(d).

fencing was the approach advocated by the joint applicants in that case.[169] His own position is uniform: ring-fencing and double leverage adjustments serve two distinct and different purposes.[170] Ring-fencing prevents the parent from "sucking a utility's assets dry" in times of severe financial distress at the parent level. Double leverage adjustments prevent the parent from earning a return in excess of its cost of capital at ratepayer expense.

152 Mr. Elgin relied on a study of Mr. Rothschild's to increase PacifiCorp's return on equity for the increased leverage of MEHC.[171] PacifiCorp argues that Mr. Rothschild did not perform a study.[172] The claim is disingenuous at best. Mr. Rothschild's study, including all underlying data and results, were provided to PacifiCorp as part of his workpapers. PacifiCorp also had ample opportunity to inquire into the empirical basis of the equity adder when Mr. Rothschild and Mr. Elgin each testified at hearing and used the study to support their recommendations. Neither of these opportunities was taken. The Company cannot now claim that Mr. Rothschild's equity adjustment was merely subjective.

153 Finally, the Company asserts that Staff's double leverage adjustment will adversely impact PacifiCorp's credit rating metrics.[173] PacifiCorp analyzed only Washington stand-alone results, even though it finances its operations on a total-company basis, and it used the Revised Protocol cost allocation methodology, even though the Commission has never adopted Revised Protocol and should not adopt it in this case for the reasons stated previously. Even the Company's analysis maintains BBB investment grade credit quality and access to capital on

[169] Tr. 1552:21-1553:7 (Elgin). Even under the joint applicants' approach, ring-fencing cannot fully insulate a subsidiary utility. *Tr. 1554:8-11 (Elgin).*
[170] Exh. No. 791T at 38:6-39:6; Tr. 1595:17-1596:7 (Elgin).
[171] Exh. No. 791T at 28:3-16 (Elgin), citing Exh. No. 151T at 54: 6-9 (Rothschild).
[172] PacifiCorp Opening Brief at 60, ¶ 181(e).
[173] PacifiCorp Opening Brief at 60, ¶ 182.

reasonable terms.[174] PacifiCorp has not demonstrated that a capital structure that produces a higher credit rating appropriately balances safety and economy.[175]

3. Conclusion on double leverage

154 MEHC intends to finance its acquisition of PacifiCorp with a substantial amount of new debt. Nevertheless, all for the benefit of MEHC's shareholders, PacifiCorp asks the Commission to ignore this new debt, pretend that the Company is a stand-alone, publicly-traded utility, and set rates that allow MEHC to recover more than its cost of capital and income taxes that are never paid to the U.S. Treasury. The acquisition of PacifiCorp through double leverage is merely a conduit for Berkshire Hathaway to realize high returns on its investment.[176]

155 The Commission should reject the Company's tactic. Staff's double leverage adjustment ensures that rates reflect the actual cost of capital in this parent-subsidiary relationship. Staff's adjustment balances the interests of ratepayers and investors, in accordance with the requirement of RCW 80.28.010(1) that rates must be just, fair, reasonable and sufficient. The Commission should adopt Staff's adjustment, which results in an overall rate of return of 7.06 percent with a corresponding adjustment to PacifiCorp's interest and tax expense.

V. ACCOUNTING ADJUSTMENTS

A. Adjustment 4.1, Capital Stock Expense

156 The Commission can reject this adjustment for three independent reasons: 1) it is retroactive ratemaking; 2) these costs are not representative of ongoing costs because they are

[174] Staff Opening Brief at 54-55, ¶ 171.
[175] *Supra*, at 28-30, ¶¶ 113-120; *see also* Staff Opening Brief at 35-36, ¶¶ 117-121.
[176] This is not speculation by Staff. It is a necessary conclusion from MEHC's consolidated balance sheet and income statement before and after the acquisition. It is also a conclusion shared equally by the investment community. *See* Exhibit 791T at 40, n.4 (Elgin).

non-recurring; and 3) the Company's adjustment amount is overstated because the Company failed to account for past ratepayer compensation for these costs.[177]

157 PacifiCorp addresses only the retroactive ratemaking issue, arguing that amortization of these costs is just like what PacifiCorp does when it amortizes over the life of a bond the issuance costs associated with that bond.[178] This argument fails to address reasons 2) and 3) above: for PacifiCorp, common equity flotation costs are non-recurring; and PacifiCorp's adjustment amount is overstated. But the Company's argument fails for two additional reasons.

158 First, bond issuance costs and stock issuance costs are different. Bond issuance costs are amortized as interest expense per the Uniform System of Accounts, not as an operating expense. Capital stock issuance costs are booked to Account 214, which has no provision for amortization at all.[179]

159 Second, it is in the rate of return where the bond interest and expected equity return are recovered through rates. Page 1 of PacifiCorp's Exhibit No. 62 shows that bond issuance expense is part of the calculation of the cost of debt. Staff's opening brief documented ten years of rate cases where the Commission considered equity flotation costs in determining the cost of common equity.[180] Of course, that was during a time period when PacifiCorp's predecessor was actually incurring these costs. However, it shows that ratepayers would pay twice if the Company's adjustment is accepted.

160 The Company now says a 0.25 percent increase in return on equity would be an "acceptable" way to recover costs the Company incurred over the last 100 years or so. This is not acceptable to Staff, and it should not be acceptable to the Commission. Indeed, the example

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[177] Staff Opening Brief at 57, ¶¶ 179 and 180.
[178] PacifiCorp Opening Brief at 28, ¶¶ 85.
[179] 18 CFR Part 101 provides the authoritative treatment of all accounts relating to capital stock and bonds for utilities. See the descriptions for Accounts 181, 201, 211, 214, 221-226 and 427-429.
[180] Staff Opening Brief at 57, footnote 303.

the Company provides where an increment was added to account for flotation costs involved Avista.[181] Avista is a utility that issues common stock, so Avista incurs flotation costs on a recurring basis. By contrast, PacifiCorp no longer issues common stock.[182] There is no reason to inflate the cost of equity to allow the Company to recover a non-recurring cost.

161 Finally, the Company downplays the fact that it has already recovered flotation costs through increments added to the return on equity during periods when PacifiCorp sold common stock to the public.[183] Staff identified cases spanning a 10-year period where the Commission added such an increment.[184] However, these are just examples. Even if all other problems with this adjustment evaporated, the Company would still have the burden to evaluate how rates have been set from the inception of the Company to present, and calculate how much in flotation costs it has already recovered, to avoid double-recovery now. Suffice it to say, the Company has not undertaken that burden.

162 For all these reasons, the Commission should reject Adjustment 4.1.

B. Adjustment 4.10a, Employee Compensation Issues

163 *Incentive Pay.* In Staff's opening brief, we argued that incentive pay included in rates should be limited to the portion that is paid out based on targets and objectives that benefit ratepayers, and exclude incentive pay based on financial targets and incentives, including such incentive payments the Company paid in the form of PacifiCorp common stock.[185]

164 PacifiCorp objects to Staff's adjustment, arguing that only 10 percent of the payments under the Annual Incentive Plan are based on earnings targets, whereas Staff's adjustment

[181] PacifiCorp Opening Brief at 28, ¶ 86.
[182] Tr. 454:22-455:1 (Wrigley).
[183] PacifiCorp Opening Brief at 29, ¶ 89.
[184] Staff Opening Brief at 57, footnote 303.
[185] Staff Opening Brief at 58-59, ¶ 185.

comprises about 15 percent of the Annual Incentive Plan payments.[186] PacifiCorp apparently misunderstands that Staff's adjustment is intended to remove payments based on all financial incentives and targets, not only those based on earnings. Consistent with Commission policy, Staff's adjustment removes the incentive pay that is based on *any* performance targets that set ratepayers at cross-purposes with shareholders.[187]

165 PacifiCorp again asks the Commission to compare its incentive pay adjustment with several levels of incentive pay – those paid in prior years, and the incentive pay level for fiscal 2004-2005. The Company argues that the adjustments of Staff and other parties should not be considered because "PacifiCorp already has reduced incentive compensation down from test-year levels."[188]

166 This argument is perplexing, since the Company's reduced proposal for test year incentive pay was not based on carefully excluding compensation based on financial targets – it was presumably the amount that the Company thought should be included in the test year. Staff is merely using the Company's proposal for total incentive pay as the starting point in making its adjustment. As Staff pointed out before,[189] its proposal is the minimum adjustment the Commission should consider. Other parties advocate greater disallowances than Staff.

167 *Medical Insurance Costs.* PacifiCorp says that Staff's challenges to the Company's 12 percent medical insurance cost escalation rate and its 90 percent employee coverage are based on "generalized studies rather than utility-industry-specific and PacifiCorp-specific data."[190]

168 In fact, Staff explained in great detail why using a 10 percent medical cost increase factor

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[186] PacifiCorp Opening Brief at 20, ¶ 61.
[187] Exh. No. 631-T at 14 (Schooley); Exh. No. 635 at 2; and Staff Opening Brief at 60, ¶ 190.
[188] PacifiCorp Opening Brief at 20-21, ¶ 61.
[189] Staff Opening Brief at 58, footnote 308.
[190] PacifiCorp Opening Brief at 21, ¶ 63.

and an 85 percent coverage factor are supported by the evidence presented in this case.[191] Staff relied on PacifiCorp-specific medical inflation trends for its electric operations;[192] PacifiCorp's own testimony regarding PacifiCorp's estimated savings accruing from PacifiCorp's changes to PacifiCorp's specific medical plan;[193] and PacifiCorp's testimony that its company-specific medical cost inflation rate compares favorably to the nationwide average.[194]

169 Staff also notes that ICNU advocates an annual medical inflation rate of 8 percent, which is supported by national surveys.[195] Staff's medical inflation rate adjustment is the minimum adjustment the Commission should consider.

170 PacifiCorp's assertion that "the Company is obligated to pay 90 percent of employee health care expenses under its current plan"[196] belies the Company's own statement that as of January 2006 (*i.e.,* now), the Company will be paying 85 percent of plan coverage, not 90 percent.[197] Long-standing ratemaking principles support the use of the factor that will be effective during the rate period, as Staff proposes. The Commission should require use of the 85 percent plan coverage factor.

C. Adjustment 4.18, Miscellaneous General Expenses (EEI dues)

171 PacifiCorp persists in claiming 25 percent of EEI dues is the most that can be disallowed.[198] Staff has already explained the factual and legal basis why a full 43.5 percent of EEI dues should be disallowed.[199]

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[191] *Id.* at 61-62, ¶¶ 195-196.
[192] Exh. No. 236 (Rosborough).
[193] Exh. No. 231-T at 9:6-10:14 (Rosborough).
[194] Exh. No. 236 (Rosborough).
[195] ICNU Opening Brief at 50, ¶ 107.
[196] PacifiCorp Opening Brief at 21, ¶ 63.
[197] Exh. No. 237-T at 7 (Rosborough).
[198] PacifiCorp Opening Brief at 22, ¶ 66.
[199] Staff Opening Brief, at 62-63, ¶¶ 199-201.

172 PacifiCorp goes on to note corrections it has made to Staff's Exhibit No. 622 (revised).[200] Staff confirms PacifiCorp has accurately stated these corrections. These corrections are not reflected in the Appendix tables to Staff's opening brief. These corrections properly reduce the net operating income impact of Staff's Adjustment 4.18 to $457 from $85,242.

D. Adjustment 4.19, RTO Expenses

173 These expenses relate to the Company's involvement in the Grid West RTO effort. The Company argues that these expenses are ordinary and necessary expenses relating to transmission reliability, planning and expansion, and therefore ratepayers should pay them through rates.[201] However, at hearing, the Company conceded it had not shown that the RTO, even if it was approved, would improve transmission reliability:

> Q. Has PacifiCorp included any evidence in this proceeding that demonstrates that the formation of a Grid West would improve transmission reliability as compared to your current transmission system?
>
> A. I don't believe we have.[202]

174 Nor has the Company shown it has provided more efficient or better service for having incurred these costs.[203] The Company simply cannot bear its burden of proving that these costs are recoverable based on these facts.

175 The Company then quotes FERC Order 2000 to suggest that these costs must be incurred as PacifiCorp's "efforts to comply with Order 2000."[204] However, at hearing, the Company conceded that the Grid West proposal does not have to satisfy Order 2000.[205]

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200 PacifiCorp Opening Brief at 22, ¶ 67.
201 PacifiCorp Opening Brief at 23, ¶ 69.
202 Tr. 504:7-11 (Wrigley).
203 Exh. No. 621T at 21:17-22:7 (Ward).
204 PacifiCorp Opening Brief at 24, ¶¶ 72 & 73.
205 Tr. 502:18-503:2 (Wrigley).

176 On prior occasions, Staff suggested PacifiCorp seek approval to defer these expenses until such time as it can prove, one way or the other, that these expenses are justified.[206] The Company declined.[207] There is no reason to require ratepayers to pay these expenses now. The Commission should accept Adjustment 4.19.

E. Adjustment 7.2, Property Taxes

177 Staff objects to this Company adjustment because it fails the "known and measurable" standard for a proper accounting adjustment: 1) it is based on "management judgment;" and 2) the Company failed to thoroughly consider the impact of how property taxes are computed.[208]

178 Thus, the Company is simply wrong to claim that Staff objects to this adjustment "for the ironic reason that the requested increase is too small."[209] The Company also misses the point. What Staff clearly was saying was that the unsupported, higher property tax increase figure filed by the Company on rebuttal cannot justify the unsupported, lower property tax increase figure filed by the Company in its direct testimony. As Mr. Kermode explained: "the reasonableness of a specific number, specifically Adjustment 7.2, is not validated by another methodology that produces a larger amount."[210]

179 Adopting the Company's approach would signal to utilities that an acceptable way to defend an unsupported figure is to offer a larger one. That is poor ratemaking and poor regulatory policy. The burden was on the Company to support its "management judgment." The Company's offering of more unsupported figures does not help; it just casts further doubt on the Company's adjustment.

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[206] Tr. 599:22-600:5 (Ward); Tr. 517:8-16 (Wrigley).
[207] *Id.*
[208] Staff Opening Brief at 65, ¶¶ 204-206.
[209] PacifiCorp Opening Brief at 27, ¶ 79 (emphasis omitted). *See also id.* at 28, ¶ 84.
[210] Tr. 590:24 to 591:2 (Kermode). As Mr. Kermode further testified, "The company has the burden to provide some type of support, detailed support that directly supports the number in which they're proposing, … I would reasonably expect some type of computation or detail that would fit to [the proposed adjustment amount]." *Tr. 587:1-7.*

180 The Company might have been able to defend an adjustment based on an examination of its total property tax bill, coupled with an evaluation of how each taxing district sets property taxes along with known changes in assessment levels. That would have taken into account the fact that property tax bills can go up, down or remain unchanged, even when the underlying value goes up or down, because of how taxing authorities actually compute property taxes.[211]

181 Instead, the Company admits it simply tied its adjustment to an increase in net plant without any consideration of these or any other offsetting factors.[212] The Commission deserves better, and ratepayers deserve better, before they are called upon to pay higher rates due to adjustments such as this. The Commission should reject Adjustment 7.2.

F. Adjustment 7.4, IRS Settlement Amortization

182 The critical and undisputed fact is that the amounts at issue here are attributable to tax liabilities the Company generated in the years 1991-1998.[213] All other points fall by the wayside, because it is simply improper retroactive ratemaking for PacifiCorp to pull these expenses from the past into the test period, and try to recover them from today's ratepayers.[214]

183 The Company argues that taxes are not owed until a deficiency is assessed.[215] That is obviously not the law; taxes are owed in the year the tax liability is incurred. As the Company truthfully told the public in its 2004 SEC Form 10K, the income tax payments the Company made in the test period include "amounts paid in settlement of *prior years' liabilities*."[216]

184 The Company argues elsewhere that "before the Commission can allocate the benefits of a … tax adjustment to ratepayers it must first determine that ratepayers bear the burden…"[217] If

[211] Staff Opening Brief at 64, ¶ 205.
[212] PacifiCorp Opening Brief at 27, ¶ 81.
[213] Exh. No. 181T at 20:9-11 (Martin).
[214] Staff Opening Brief at 65, ¶ 209.
[215] PacifiCorp Opening Brief at 54, ¶ 164.
[216] Exh. No. 183 at 2, 1st ¶ under the table (emphasis added).
[217] Exh. No. 181T at 9:21-23 (Martin). *See also* PacifiCorp Opening Brief at 48-49, ¶¶ 152-153.

there were no retroactive ratemaking problems, fairness would require the converse to be true: *i.e.*, before the Commission can allocate the *burden* [the tax settlement adjustments] to ratepayers, it must first determine that ratepayers enjoy the *benefits* [the additional revenues or lower expenses associated with those tax adjustments].

185 In Adjustment 7.4, the Company fails to accept the consequences of its own argument by failing to add any revenues or reduced expenses to match the additional tax liability it now wants to collect.[218] That is just one more reason for rejecting the Company's Adjustment 7.4.

G. Adjustment 7.5, Malin Midpoint

186 Under unique "safe harbor" lease provisions of the Tax Code, the Company sold the Malin Midpoint transmission line to Amoco. The Tax Code requires that Amoco be treated as the owner of that line for tax purposes. The Commission's treatment gives PacifiCorp's gain on that tax sale to ratepayers.[219]

187 If the Commission focuses on these basic facts, it is clear Staff's Adjustment 7.5 is appropriate. In other words, this is a tax issue, so it is critical to keep clear the distinction between tax basis ownership and ownership outside the tax context.

188 Staff did its part. As Mr. Kermode testified: "As far as tax law is concerned, PacifiCorp 'sold' the transmission line to Amoco …for which Amoco paid PacifiCorp a $44 million up-front cash payment for the purchase of the Malin Midpoint utility plant."[220] Staff's Adjustment 7.5 consistently treats the transaction in this manner.

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[218] Exh. No. 601T at 17:13-19:10 (Kermode). Another problem with the Company's Adjustment 7.4 is that it seeks to recover over five years the taxes it incurred over eight years. If any amortization period is used, it should match the period over which the taxes were incurred: eight years. *Id. at 19:12-20:6 (Kermode).*
[219] Exh. No. 601T at 22:6-24:3 (Kermode).
[220] Exh. No. 601T at 22:14-19 to 23:1 (Kermode). He also correctly pointed out that for other than tax purposes, no ownership interest was transferred. *Exh. No. 601T at 25:1-7 (Kermode).*

189 The Company does not do its part. The Company confuses the issue by blurring this distinction between tax treatment and other than tax treatment. For example, PacifiCorp supports its case by citing Mr. Kermode's testimony that PacifiCorp did not transfer true ownership of the transmission line to Amoco.[221] However, the Company failed to mention Mr. Kermode's testimony that clearly states for tax purposes, the tax law treats the transaction as a tax basis sale to Amoco and recognizes Amoco as its nominal owner.[222]

190 This leads PacifiCorp to mistakenly argue that for ratemaking purposes, the Company must follow the Tax Code's tax normalization requirements with respect to the gain on the sale.[223] The Company is mistaken because tax normalization is a tax basis issue. Normalization accounting "normalizes" the difference between regulatory depreciation expense and tax-basis depreciation expense.[224] However, in this instance, PacifiCorp sold the transmission line to Amoco for tax basis purposes. Consequently, PacifiCorp has no tax basis depreciation associated with the Malin Midpoint transmission line, and therefore, there is simply nothing for PacifiCorp to normalize.[225]

191 The Company also alleges that Staff's adjustment "double counts" by both amortizing the gain and reducing rate base.[226] In fact, there is no double count. The amortized gain simply allocates the gain over the life of the associated plant.[227] The dollars associated with the gain on the sale were not provided by investors. The rate base reduction is required so PacifiCorp will

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[221] PacifiCorp Opening Brief at 52, ¶ 157.
[222] *See, e.g.,* Exh. No. 601T at 22:14-17 (Kermode).
[223] PacifiCorp Opening Brief at 52, ¶ 158.
[224] Exh. No. 601T at 38:17-39:8 (Kermode).
[225] The Company concedes the transaction was "for tax purposes only, … a "sale and leaseback." *PacifiCorp Opening Brief at 53, ¶ 161.* We hope it is clear to the Commission, if not the Company, that it is not appropriate for any taxpayer to take tax-basis depreciation expense on an asset it sold "for tax purposes."
[226] PacifiCorp Opening Brief at 52, ¶ 158; Exh. No. 281T at 3:23-25 (Elliott).
[227] Exh. No. 601T at 30:9-21 (Kermode).

not earn a return on capital its investors did not supply. This has nothing to do with a reduction in the "equity interest in Malin Line," as PacifiCorp suggests.[228]

192 In short, normalization requirements do not apply, and there is no "double count." Staff's Adjustment 7.5 simply allocates the gain from the Malin Midpoint tax basis sale to the ratepayer, and the rate base reduction prevents the Company from earning a return on the proceeds, which are not investor-contributed capital. This treatment is fully justified.

193 Indeed, Staff's analysis is fully supported by the Tax Code[229] and the legislative history.[230] It is also supported by case law. In *Papago Tribal Utility Authority v. FERC,*[231] the Ninth Circuit affirmed a FERC decision requiring the same treatment as the Commission requires: amortize the gain over the life of the lease, and remove the unamortized portion from rate base.

194 In that matter, FERC's initial decision rejected the same argument PacifiCorp is making here, *i.e.*, that the Tax Code's normalization requirements applied to proceeds from a "safe harbor" sale and leaseback transaction:

> [Economic Recovery Tax Act], it is true, required utilities to normalize ACRS deductions and, in certain circumstances, investment tax credits. But there is nothing in the statute that requires normalization of the proceeds…. Nor is there any general doctrine of tax law that mandates giving the proceeds derived from selling an asset the same tax treatment that would have been accorded to the asset if the tax payer had retained it.[232]

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[228] PacifiCorp Opening Brief at 52, ¶ 159.
[229] 26 U.S.C. § 168(f)(8)(A)(ii). *See also* Staff Opening Brief at 67, ¶ 214 (quoting the Tax Code).
[230] In the Report contained in Exh. No. 606 (Kermode), page 4, 5th new ¶, Congress states that "the transaction is treated as a sale to Y and a leaseback to X." On page 5, 1st ¶, Congress makes clear that the sale and leaseback applies to "section 38 property," which, as noted on page 4, last two ¶¶, means physical property, not tax benefits.
[231] 773 F.2d 1056, 1062-65 (9th Cir. 1985), *cert. denied*, 475 U.S. 1515 (1986).
[232] *In re Arizona Public Service Company*, Docket No. ER81-179-000 (Phase II), "Initial Decision on Treatment of 'Safe Harbor' Proceeds," 22 FERC ¶ 63,062 at 65,233 (February 25, 1983). Indeed, FERC has consistently rejected utility arguments for normalization accounting for safe harbor lease proceeds, including a 1997 decision involving PacifiCorp, in which the Company unsuccessfully argued that normalization was required. *In re PacifiCorp*, Docket No. AC91-110-001, "Order Denying Rehearing," 81 FERC ¶ 61,225 at 61,951-952 (November 18, 1997).

195 FERC affirmed.[233] In doing so, FERC also rejected the same argument about "double counting" that PacifiCorp is now making:

> The issue [regarding the reduction to rate base] is not whether the proceeds were contributed by the ratepayers but whether they were contributed by the investors. …It follows then that a utility is not entitled to earn a return on that portion of rate base financed by sources other than the owner's capital. … The safe harbor lease proceeds do not represent investor-contributed capital.[234]

196 The Ninth Circuit Court of Appeals affirmed. In doing so, the court explicitly agreed with FERC that the Tax Code did not clearly require normalization in these circumstances.[235]

197 In the end, Staff's adjustment makes sense, and it is consistent with Commission policy, the facts and the law. By contrast, PacifiCorp's theory confuses the facts, departs from Commission policy, disregards the actual words of the Tax Code, and otherwise has no legal support.[236] The Commission should accept Staff's Adjustment 7.5.

H. Working Capital Adjustments: Adjustment 8.1, Update Cash Working Capital; Adjustment 8.1a, Remove Current Assets; Adjustment 8.2, Trapper Mine Rate Base; Adjustment 8.3, Jim Bridger Mine Rate Base; And Adjustment 8.7, Dave Johnston Mine Closure

198 The Staff thoroughly addressed each challenge the Company made to Staff's investor-supplied working capital analysis, and showed why the Company has no investor-supplied working capital.[237] The Company now uses a 1979 FERC decision to claim that lead lag studies are "state-of-the art" and should be used instead of the Commission's method.[238]

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[233] *In re Arizona Public Service Company*, Docket No. ER81-179-000 (Phase II), Opinion No. 193, "Opinion and Order Affirming Initial Decision," 25 FERC ¶ 61,092 (October 19, 1983).
[234] 25 FERC at 61,309 (citations omitted).
[235] 773 F.2d at 1064.
[236] The Company continues to rely on an IRS private letter ruling it conceded at hearing has no precedential value. *PacifiCorp Opening Brief at 53, ¶ 161; Exh. No. 821T at 2:17-19 (Elliott).* The letter ruling itself states "Section 6110(j)(3) of the Internal Revenue Code provides that this letter ruling may not be cited or relied on as precedent." *Exh. No. 282 at 3, second to last* ¶.
[237] Staff Opening Brief at 68-73, ¶¶ 217-229.
[238] PacifiCorp Opening Brief at 32, ¶ 100 and at 33-34, ¶¶ 102 & 103.

199 First, there is nothing in the record that suggests lead lag studies are "state-of-the-art," let alone anything that suggests that PacifiCorp's version rises to that level. Second, in 1995, sixteen years after the FERC order relied on by PacifiCorp, the Commission evaluated the lead lag and investor-supplied working capital approaches, and confirmed the latter method for use in this jurisdiction.[239]

200 The Company supports its theory by the false claim that Mr. Schooley concluded that "the Company must, on average, receive payments for service before it is required to pay its bills," and that "as a result of this conclusion," Staff removed various current assets from rate base.[240] In fact, Mr. Schooley made no such conclusion. Indeed, he made no claim whatsoever about cash receipts or payments. The Company is simply confusing the differences between "cash working capital" and "investor-supplied working capital."

201 Moreover, Staff did not remove current assets from rate base as the result of any conclusion about receipts and payments. In fact, Staff *included* these items to the extent they contribute to a positive balance in investor-supplied working capital.

202 PacifiCorp goes on to suggest the Commission's method is "outmoded, less accurate and unreliable,"[241] but offers no factual basis for this. By contrast, Staff cited numerous Commission decisions, many involving PacifiCorp, wherein the Commission expressed its satisfaction with the investor-supplied working capital method.[242]

203 PacifiCorp speculates that the Commission's method is "ignored" because it does not measure cash working capital needs.[243] However, it is the Company who ignores the fact that the

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[239] *Utilities & Transp. Comm'n v. US WEST Communications, Inc.*, Docket No. UT-950200, 15th Supp. Order at 68 (April 11, 1996).
[240] PacifiCorp Opening Brief at 33, ¶ 101.
[241] PacifiCorp Opening Brief at 33, ¶ 102.
[242] Staff Opening Brief at 69, ¶ 218.
[243] PacifiCorp Opening Brief at 34, ¶ 107.

investor-supplied working capital approach seeks to determine the amount of working capital investors supply.[244] The lead lag method does not focus on the manner in which working capital is supplied.

204 A lead lag study is no panacea; it simply takes a utility's billing and collection practices as they are, assumes these practices meet the best terms available, and rewards the utility with higher rates if it pays out dollars faster than it collects them.[245]

205 Finally, PacifiCorp complains the Commission's method can be used to generate different results.[246] To this end, PacifiCorp attempted to recreate a Staff working capital exhibit from the 2003 PacifiCorp rate case.[247] However, the exhibits the Company created are rife with misinformation and errors and must be disregarded by the Commission.[248]

206 Staff's calculation of investor-supplied working capital conforms to the long-standing Commission method, it is provided with great detail,[249] and it shows that investors are not supplying working capital. Staff's corresponding removal of current asset accounts from rate base is required because these accounts are included in the calculation of investor-supplied working capital.

I. Adjustment 5.1, NPC T3 Study; Adjustment 8.4, Proforma Major Plant Additions; And Adjustment 8.10, Production Factor Rate Base

207 These adjustments are interrelated. Adjustment 5.1, normalized proforma net power costs (NPC), contains the production factor. Adjustments 8.4 and 8.10 apply the production factor to production rate base.

[244] Tr. 617:15-24 (Schooley).
[245] Staff Opening Brief at 72-73, ¶ 228.
[246] PacifiCorp Opening Brief at 35, ¶ 108.
[247] Exh. No. 195-T at 13:1-14:12 and Exh. No. 199 (Wrigley).
[248] Tr. 475:23-482:10 (Wrigley).
[249] Exh. No. 637 (Schooley) including electronic attachments.

208 Public Counsel wrongly states that "[t]he Staff method accepted by the company relates to the allocation of production plant to the Washington jurisdiction."[250] In fact, Staff's method takes all allocated production plant, including depreciation reserves and depreciation expense at the proforma level, and steps it back to the test year consumption via the production factor.[251] This is a consistent and appropriate calculation. The Company accepted this adjustment.[252] The Commission should not accept Public Counsel's adjustments.

209 ICNU's primary complaint seems to be that the proforma production costs and production plant should be allocated using a proforma allocation factor.[253] This refinement to the Commission's long-standing method of determining proforma power costs may be acceptable in the future. It may also produce a negligible difference. For now, Staff's production factor approach is reasonable and should be accepted.

J. Adjustment 8.14, Miscellaneous Deferred Debits

210 Public Counsel states the fundamentally correct point that costs that are deferred without Commission authorization, and without substantive reason for rate base inclusion, should not be accepted for ratemaking.[254] Staff concurs with Public Counsel. Staff adhered to this principle in Staff Adjustments 8.12, 8.13 and 8.14, which dealt with appropriate treatments of certain deferred costs, with and without Commission authorization.

K. Acquisition Premium

211 Public Counsel contends that the Company failed to demonstrate that the plant acquisition adjustments recorded in PacifiCorp's books are in the best interest of ratepayers

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[250] Public Counsel Opening Brief at 20, ¶ 44.
[251] Exh. No. 638 (Schooley).
[252] Exh. No. 195-T at 3:8-10 and Exh. No. 197 at 2 (Wrigley).
[253] ICNU Opening Brief at 40-43, ¶¶ 84-90.
[254] Public Counsel Opening Brief at 18, ¶¶ 39-41.

because the Company failed to supply specific supporting justification.[255] Staff agrees that acquisition premiums must be approved for inclusion in rate base.[256] However, Mr. Schooley explained Staff's concurrence with the Company's demonstration of prudence.[257] Staff supports the Company's request in its opening brief at ¶¶114-115 to formally approve the Yampa acquisition premium.

L. Adjustment 3.8, Update to Revenues

212 Public Counsel does not explain why it listed this adjustment as "contested."[258] In fact, PacifiCorp accepted Public Counsel witness Mr. Effron's adjustment, and even recalculated it to a higher amount.[259]

M. WAPA Transmission Revenue

213 ICNU proposes to increase other revenues by imputing additional revenues at current FERC transmission rates for a transmission contract with WAPA. Apparently, this fixed-rate, 80-year contract has no escalation clause requiring that transmission rates be updated over time.[260] PacifiCorp defends the contract as compensatory and argues that no adjustment is necessary.[261] PacifiCorp opposes the adjustment, but mentions an alternative treatment which disallows all revenues and related costs and rate base.[262]

214 Staff is not opposed to either approach for disallowing an imprudent contract, but Staff did not investigate this contract and therefore takes no position on this issue.

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[255] Public Counsel Opening Brief at 18, ¶ 42.
[256] Exh. No. 631T at 60:1-4 (Schooley).
[257] Exh. No. 631-T at 61:8-13 (Schooley).
[258] Public Counsel Opening Brief at 20, ¶45.
[259] Exh. No. 195-T at 3:3-7 and Exh. No. 197 at 1 (Wrigley).
[260] ICNU Opening Brief at 57-59, ¶¶ 121-123.
[261] PacifiCorp Opening Brief at 26, ¶ 76.
[262] PacifiCorp Opening Brief at 26, ¶ 77.

VI. LOW INCOME ASSISTANCE

215 PacifiCorp and the Energy Project disagree on two issues related to low income assistance programs: 1) the level of funding for low income bill assistance; and 2) the matching funding rule for the low-income weatherization program. When considering these issues, it is easy to lose sight of the fact that the money used to fund these programs comes from ratepayers. Consequently, the Commission should take care to assure ratepayers' money is used appropriately.

A. The Commission Should Order A Funding Increase For The Bill Assistance Program To The Original Level (0.34 Percent Of Revenue) And A 10 Percent Increase In The Energy Credit

216 While the parties agree that an increase in funding for low-income bill assistance is appropriate, they disagree on the level of increase. The Energy Project recommends a funding increase that would put PacifiCorp's program funding "on par with Avista," at 0.64 percent of revenue.[263] This would set PacifiCorp's bill assistance funding at about $1,354,000 annually; a 136 percent increase.[264]

217 The Energy Project also recommends that the low income participant benefit level be increased "to protect [participants] from the rate increases that have occurred since the program began." This would be done by either increasing the level of the rate discount, or by making the program available year round, rather than just during the heating season.[265]

218 PacifiCorp agrees to increase funding for low-income bill assistance by 30 percent, which is the same percentage as all residential price increases since the program went into effect in

[263] Energy Project Opening Brief at 5. Originally, the Energy Project recommended that program funding be set at 0.75 percent of revenue. *Exh. No. 651T at 16:20-22 (Eberdt).*
[264] PacifiCorp's current low income program surcharge collects about $574,000 annually for bill assistance.
[265] Energy Project Opening Brief at 5.

2001, including the Company's proposed rate increase in this proceeding.[266] This would return funding to its original level of 0.34 percent of revenue, or about $745,000 annually.[267]

219 The Company also agrees to increase the program's energy credit (*i.e.*, the participant rate discount) by 10 percent, in order to increase the participant benefits.[268]

220 The Commission should adopt the Company's proposal to increase funding for bill assistance to its original level, and to increase the energy credit by 10 percent. This strikes a reasonable balance between providing meaningful benefit levels, and reaching as many eligible customers as possible. As noted by the Energy Project,[269] PacifiCorp's program was developed cooperatively by the community action agencies, Staff and the Company, with this balancing in mind. The Company's proposal better reflects this original balancing effort.

221 The Energy Project's reliance on Avista's program funding level is not justified. That funding level was established in an uncontested tariff filing,[270] and has evolved as part of settlement negotiations in rate cases.[271] Consequently, it should not be used as precedent for setting a funding level for PacifiCorp.

222 Moreover, PacifiCorp's rates are lower than Avista's,[272] so equal budget and benefit levels between utilities may not be appropriate. The characteristics of the individual utility and service area need to be taken in account for each program, rather than just using the highest funded program as the standard.

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[266] PacifiCorp Opening Brief at 62, ¶184 and Exh. No. 5T at 19:15-18 (MacRitchie). Excluding the Company's proposed rate increase in this proceeding, residential rates have increased by 12 percent since the program went into effect.
[267] In addition, PacifiCorp has committed to a contribution of $80,000 per year for five years in the MidAmerican acquisition settlement. This represents a 14 percent increase in current funding. *In re Application of MidAmerican Energy Holding Co. and PacifiCorp*, Docket No. UE-051090, Order No. 7 at 9, ¶25 (February 22, 2006).
[268] Exh. No. 7, Company Response to Staff Data Request No. 376.
[269] Energy Project Opening Brief at 3.
[270] Docket No. UE-014436. The tariff was effective May 2, 2001.
[271] *Utilities & Transp. Comm'n v. Avista Corp.*, Docket Nos. UE-050482 & UG-050483, Order No. 5 (December 21, 2005).
[272] PacifiCorp Opening Brief at 62, ¶185. *See also* the rate comparisons in Exh. Nos. 764 and 765.

223 This is not to suggest that the parties should not occasionally reassess the benefit and funding levels for bill assistance. The Company has made commitments in this proceeding[273] and in the MidAmerican acquisition proceeding[274] to work with the Energy Project, Staff and other parties to track low-income issues and pertinent data. Accordingly, the parties should be able to analytically evaluate the propriety and need for increasing benefit levels and the possibility of expanding the program beyond the heating season.

B. The Commission Should Deny The Energy Project's Request To Remove The 50 Percent Matching Rule From The Low-Income Weatherization Program

224 The second area of disagreement between the Energy Project and PacifiCorp involves the low-income weatherization program. Currently, the Company pays 50 percent of the costs for cost-effective measures installed in weatherized homes, until Matchmaker[275] funding is exhausted. Thereafter, the Company pays 100 percent of the costs. The Company's commitment is capped at $1 million annually.[276]

225 The Energy Project wants to eliminate this "50 percent matching rule." However, PacifiCorp argues that the Commission should retain the rule because it "is designed to leverage the Company's funding with grants received by our partnering agencies…in order to have the maximum number of customer homes weatherized."[277]

226 The Commission should retain the current policy for a 50 percent match until Matchmaker funds are exhausted. The Company's goal of maximizing the use of other funding sources is solidly in the interest of ratepayers.

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[273] *Id.* at 62, ¶186 and Tr. 296:13-298:6 (MacRitchie).
[274] *In re Application of MidAmerican Energy Holding Co. and PacifiCorp*, *supra*, Order No. 7 at 9, ¶25.
[275] Matchmaker funding comes from state and federal sources and is administered by the Department of Community, Trade and Economic Development.
[276] Tr. 298:16-299:1 (MacRitchie), Exh. No. 5T at 21:3-9 (MacRitchie) and Energy Project Opening Brief at 9.
[277] Exh. No. 5T at 20:22-21:2 (MacRitchie).

227 The Energy Project's reasons for eliminating the 50 percent matching rule are not well founded. The Energy Project argues that there is "no legitimate rationale" for the 50 percent matching rule and that it "effectively reduce[s] the number of customers who received the needed assistance."[278] However, the same amount of money is available to the agencies with or without the 50 percent matching rule, so the same number of customers will be served. PacifiCorp has an annual budget of $1 million for low income weatherization,[279] so the agencies can access matching funds up to $1 million.

228 The Energy Project also argues that "if the agency can't draw down all of their [Energy Matchmaker] funds by spending PacifiCorp funds at the 50 percent rate, they could lose the use of the unspent [Energy Matchmaker] funds."[280] This suggests the issue is a matter of timing and how quickly the money can be spent. However, this also suggests that if the 50 percent matching rule is eliminated, the agencies could spend all of the PacifiCorp money, but not be able to spend the entire Matchmaker funding, thereby failing to fully leverage other funding sources for ratepayers.

229 In his testimony, Mr. Eberdt argued that eliminating the 50 percent matching rule "would simplify bookkeeping for the agencies considerably" and that "the energy efficiency program should stand on its own without dependence on other, unpredictable sources of funding."[281] In fact, PacifiCorp's program is not dependent on other sources of funding. The Company will pay 100 percent of the costs (up to $1 million) once funding is exhausted. This means that if there is no other funding source, PacifiCorp's $1 million program funding would still be available.

[278] *Id.* at 11.
[279] *Id.* at 21:8.
[280] Energy Project Opening Brief at 10.
[281] Exh. No. 651T at 10:8-10 (Eberdt).

230 Moreover, the 50 percent matching rule gives the agencies the incentive to access these other funds to the maximum extent they are available, making ratepayer dollars go as far as possible. A bookkeeping simplification should not trump this benefit.

231 In summary, the Commission should order a funding increase for the bill assistance program to the original level (0.34 percent of revenue) and an increase in the energy credit by 10 percent, as agreed between Company and Staff, with the expectation that the parties will work cooperatively to reassess overall funding and energy credit levels. The Commission should also deny the Energy Project's request to eliminate the 50 percent matching rule from the low-income weatherization program.

VII. CONCLUSIONS

232 For the reasons stated above, and in Staff's opening brief, PacifiCorp has not sustained its burden of proving its requested 13.5 percent[282] rate increase request is justified. The Commission should reject the tariffs the Company filed in this docket and order the Company to file tariffs to effect a 4.7 percent rate decrease,[283] spread on an equal percentage basis.[284]

DATED this 6th day of March, 2006.

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[282] PacifiCorp Opening Brief at 1, ¶ 2.
[283] *See* Staff Opening Brief at Appendix page 7, Table 5, and at 11-33, Table 8.
[284] Exh. No. 711T at 3:3-4 and at 9:5-8 (Steward, Iverson, Lazar).