BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

REPLY BRIEF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

March 6, 2006

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. ARGUMENT 3

A. The Commission Should Adopt an Allocation Methodology That Ensures That Washington Ratepayers Pay Only Those Costs That Are Prudently Incurred to Serve Washington 3

1. PacifiCorp's Own Actions Are the Reason the Company Does Not, and Will Not Have, a Consistent Allocation Methodology 4

2. The Commission Should Not Adopt PacifiCorp's Proposed Washington Version of the Revised Protocol Merely Because Other States Have Adopted Their Own Versions of the Revised Protocol 5

3. ICNU Has Proposed a Long-Term, Functional Cost Allocation Methodology That Is Fair to PacifiCorp and Washington Customers 6

4. PacifiCorp's Utah Generation Facilities Should Be Excluded from Rates Because They Are Not Used and Useful to Washington 8

5. The Revised Protocol Harms Washington By Requiring Washington Customers to Subsidize the High Costs of Utah Load Growth 9

B. PacifiCorp Has Failed to Demonstrate That the Commission Should Adopt Its Proposed PCAM 11

C. There Is No Evidence to Support PacifiCorp's Hydro Deferral 13

D. The Commission Should Adopt ICNU's WAPA Contract Adjustment 13

E. The Company Should Not Be Permitted to Manipulate Its Test Year to Require Washington to Pay a Larger Portion of Utah Load Growth than Is Required under the Revised Protocol 15

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F. The Commission Should Adopt ICNU's Reasonable 9.8% Return on Equity and Proposed Capital Structure 15

G. The Failure to Make ICNU's Tax Adjustment Will Provide PacifiCorp's Parent Company with Excessive Returns 20

H. PacifiCorp's RTO Costs Should Be Excluded from Rates 22

I. ICNU Agrees with the PacifiCorp/Staff ScottishPower Cross Charge Adjustment 23

III. CONCLUSION 23

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TABLE OF AUTHORITIES

Case **Page**

Bonneville Power Admin. et al., 112 FERC ¶ 61,012 (July 1, 2005) 22

People's Org. for Wash. Energy Resources v. WUTC, 101 Wn.2d 425 (1984) 8

People's Org. for Wash. Energy Resources v. WUTC, 104 Wn.2d 798 (1985) 9

Puget Sound Energy, Inc., 88 FERC ¶ 61,001 (July 15, 1999) 8

Re PacifiCorp, OPUC Docket No. UE 116, Order No. 01-787 (Sept. 7, 2001) 14

Re PacifiCorp, OPUC Docket No. UE 170, Order No. 05-1050 (Sept. 28, 2005) 14, 16

Re PacifiCorp, UPSC Docket No. 99-035-10, Report and Order (May 24, 2000). 14

Re PacifiCorp, UPSC Docket No. 04-035-42, Report and Order (Feb. 25, 2005). 14

Re Pac. Power & Light Co., OPUC Docket No. UF 4000, Order No. 88-767 (July 15, 1988) 2, 4

Re Pac. Power & Light Co., Docket No. U-87-1338-AT, Second Suppl. Order (July 15, 1988) 1, 4

Re Puget Sound Energy, Docket No. UE-010410, Order Denying Petition to Amend Accounting Order (Nov. 9, 2001) 22

State ex rel. Pac. Power & Light v. Dep't of Pub. Works et al., 143 Wash. 67 (1927). 9

WUTC v. PacifiCorp, Docket No. UE-991832, Third Suppl. Order (Aug. 9, 2000). 4, 14

WUTC v. PacifiCorp, Docket No. UE-032065, Order No. 06 (Oct. 27, 2004) 4, 5, 14

WUTC v. Pac. Power & Light, Docket No. U-83-57, Second Suppl. Order (June 12, 1984). 8

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I. INTRODUCTION

1 PacifiCorp's Initial Brief is based on the misguided premise that it is entitled to a rate increase because: 1) it has maintained a "low-cost advantage" over Avista and Puget Sound Energy ("PSE") since the merger of Pacific Power & Light ("PP&L") and Utah Power & Light ("UP&L") (the "Merger");[1/] 2) its rates allegedly have been stable since the Merger;[2/] and 3) a rate reduction should be rejected as too "aggressive."[3/] PacifiCorp's arguments ignore the legal standard that applies in this case. The issue is not how PacifiCorp's rates compare to other utilities. Instead, PacifiCorp is required to prove that it is entitled to a rate increase based on its prudently incurred costs of providing service to Washington customers.

2 PacifiCorp's costs can only be determined by applying a jurisdictional cost allocation methodology that is fair to Washington ratepayers. In fact, PacifiCorp selectively applies allocation methodologies that are consistently detrimental to Washington ratepayers. PacifiCorp admits that its arguments in favor of the Revised Protocol are counterintuitive,[4/] but nevertheless urges the Commission to ignore the facts and adopt the Revised Protocol for the altruistic purpose of obtaining consistent results among the states that regulate PacifiCorp. Consider the following:

- PP&L enjoyed a pre-merger cost advantage over UP&L;[5/]

1/ PacifiCorp Initial Brief at 2.
2/ Id. at 10.
3/ Id. at 3.
4/ Id. at 11.
5/ Re PP&L, Docket No. U-87-1338-AT, Second Suppl. Order at 14 (July 15, 1988); Exh. No. 491TC at 20 (Falkenberg Direct).

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- Since the Merger, loads in Utah have grown much faster than loads in Washington;[6]

- The Company's new marginal resources that serve Utah are more expensive than historic resources;

- PacifiCorp agreed to take the risk of inconsistent rate treatment in the various jurisdictions;[7]

- PacifiCorp's rates in Utah have gone down during the time since the Merger, while its rates in Washington have gone up;[8] and

- Adoption of the Revised Protocol in Washington would only perpetuate the bias in favor of PacifiCorp's eastern control area to the detriment of Washington.

3 PacifiCorp also bemoans its financial condition and claims that a rate increase is necessary to support its capital expenditure requirements that may soon exceed $1 billion annually.[9] These claims are both unsupported and irrelevant. The truth is that PacifiCorp has by far the strongest credit rating of any Washington investor-owned utility. Furthermore, the Company is attractive from an investor standpoint, given that it will soon be purchased by Warren Buffet, arguably the world's most savvy investor. Finally, the capital needs of the Company have largely been driven by extraordinary load growth in Utah.[10] In contrast, the load growth and economy of

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[6] Exh. No. 335 at 2 (Retail Load Growth (Firm and Non Firm MW)).

[7] Exh. No. 491TC at 20: 19-21 (Falkenberg Direct); Re PP&L, Oregon Public Utility Commission ("OPUC") Docket No. UF 4000, Order No. 88-767 at 22 (July 15, 1988).

[8] Exh. No. 764 (Staff Response to Commission Bench Request ("BR") No. 25).

[9] PacifiCorp Initial Brief at 2.

[10] See Exh. No. 541TC at 56: 16 - 118: 8 (Buckley Direct); Exh. No. 491TC at 14 (Falkenberg Direct); TR. at 327-329 (MacRitchie).

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PacifiCorp's service territory in Washington remains relatively flat.[11/] Under these circumstances, there is no credible evidence that PacifiCorp's financial condition is undermining its ability to serve Washington customers.

4 Staff, Public Counsel and ICNU have made a convincing case that PacifiCorp's rates should be decreased rather than increased. As a result, PacifiCorp has not met its burden of proof that it is entitled to any rate increase.

II. ARGUMENT

A. The Commission Should Adopt an Allocation Methodology That Ensures That Washington Ratepayers Pay Only Those Costs That Are Prudently Incurred to Serve Washington

5 PacifiCorp makes a number of arguments in support of adopting the Revised Protocol, all of which seem to have little to do with whether the Revised Protocol produces a reasonable outcome in Washington. These include:

- PacifiCorp's failed 17-year effort to get all the states to agree to a consistent allocation methodology (a failure that PacifiCorp implies is somehow the fault of Staff and Intervenors);
- Staff and Intervenors' alleged failure to present a workable allocation alternative to the Revised Protocol; and
- The fact that PacifiCorp's rates have allegedly been stable and are lower than the rates of Avista and PSE.

As shown below, these claims are unfounded.

11/ Exh. No. 491TC at 12-13 (Falkenberg Direct); Exh. No. 531T at 15: 15 – 17: 3 (Blackmon Direct); Exh. No. 533 at 1-2 (Economic and Population Growth); Exh. No. 335 at 2 (Retail Load Growth (Firm & Non Firm MW)).

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1. PacifiCorp's Own Actions Are the Reason the Company Does Not, and Will Not, Have a Consistent Allocation Methodology

6 PacifiCorp directly criticizes the parties, as well as implicitly criticizes the Commission, for failing to resolve the jurisdictional allocation issue since the Merger.[12/] However, the lack of an allocation method in Washington is a problem of PacifiCorp's own making. PacifiCorp created the problem when it merged the two systems with the knowledge that the states in which the two utilities operated had fundamentally different beliefs about how the costs and benefits of the combined systems should be allocated.[13/] Hence, the problems cited by PacifiCorp related to jurisdictional allocation stem from the fact that the Company was too anxious to consummate the Merger and did not take the time to resolve this issue upfront. The sense of urgency the Company tries to impose at this point is due to the fact that it assumed the obligation to absorb any costs not allocated consistently among the jurisdictions.

7 Also, the fact that the Commission has not ruled on the Revised Protocol is due to PacifiCorp's failure to present the issue for decision. Since the Merger, PacifiCorp has elected to settle all its rate cases while specifically requesting that the Commission defer and not resolve the cost allocation issue.[14/] For example, PacifiCorp chose to put forward the Original Protocol in its last rate case and to enter into a

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12/ See, e.g., PacifiCorp Initial Brief at 3-5.

13/ Exh. No. 491TC at 18-20 (Falkenberg Direct); Re PP&L, OPUC Docket No. UF 4000, Order No. 88-767 at 22; Re PP&L, Docket No. U-87-1338-AT, Second Suppl. Order at 13-14 (July 15, 1988).

14/ WUTC v. PacifiCorp, Docket No. UE-032065, Order No. 06 (Oct. 27, 2004); WUTC v. PacifiCorp, Docket No. UE-991832, Third Suppl. Order (Aug. 9, 2000).

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settlement with Staff using that method.[15] That ensured that, instead of having the issue decided in that case, interstate cost allocation would be an issue in this proceeding. The Company could have requested that the Revised Protocol be applied in its previous case, but decided not to because it would have reduced its revenue requirement.[16] Hence, the lack of an approved methodology in Washington stems from PacifiCorp's own opportunistic approach to settling prior cases, rather than a lack of diligence on the part of this Commission or the other parties to this case.

2. The Commission Should Not Adopt PacifiCorp's Proposed Washington Version of the Revised Protocol Merely Because Other States Have Adopted Their Own Versions of the Revised Protocol

8 PacifiCorp relies on the fact that the commissions in Utah, Oregon, Wyoming, and Idaho have adopted the Revised Protocol as a reason for Washington to follow their lead.[17] PacifiCorp concludes that Washington should sacrifice its interests to support a consistent outcome among the states. This argument is wrong for two reasons. First, as ICNU noted in its Initial Brief, the Revised Protocol proposed in Washington is different from that adopted in other states.[18] Second, the customers in Oregon, Idaho, and Utah received inducements to approve the Revised Protocol, so it was not merely an exercise in trying to determine the best method.[19] No such inducements were offered in Washington. In reality, if Washington adopts the Revised Protocol, there will be no consistency.

15/ See Exh. No. 491TC at 22.
16/ WUTC v. PacifiCorp, Docket No. UE-032065, Order No. 06 at ¶ 47 (The use of the Revised Protocol in the last PacifiCorp rate case would have reduced rates by approximately $2.5 million.).
17/ PacifiCorp Initial Brief at 6-8.
18/ ICNU Initial Brief at 9-11, 14-16.
19/ Id. at 9-11.

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9 The best example of inconsistency is that Utah and Idaho have rate caps, but Washington does not.[20/] The record shows that the Company has placed Utah and Idaho in favored positions by granting them rate caps to prevent the full cost of the Revised Protocol from being allocated to those states.[21/] Thus, the Company views a consistent allocation as one that favors the eastern states, and which places the western states at a continuing disadvantage. PacifiCorp makes much of the "value of achieving consensus and closure regarding interjurisdictional cost allocation methods."[22/] In this case, the consensus the Company talks about was purchased in the form of rate concessions to the eastern states. No similar proposal was made in Washington.

3. ICNU Has Proposed a Long-Term, Functional Cost Allocation Methodology That Is Fair to PacifiCorp and Washington Customers

10 PacifiCorp incorrectly asserts that ICNU is urging further study of cost allocation issues[23/] and that ICNU's alternative to the Revised Protocol is "half-baked and unworkable."[24/] After criticizing Mr. Black's proposal, PacifiCorp concludes that "Mr. Falkenberg's approach is about as simplistic as Mr. Blacks."[25/] While ICNU's approach may be simple, it certainly is not simplistic. ICNU presented two fully developed proposals for the Commission's consideration. First, ICNU recommended the Pre-Merger Method that can be applied now and in future cases.[26/] The Pre-Merger Method utilizes the Revised Protocol with all of its complex allocation formulas, with only one

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20/ Exh. No. 491TC at 23, 31 (Falkenberg Direct); Exh. No. 541TC at 37-38, 44 (Buckley Direct).
21/ Exh. No. 491TC at 23, 31 (Falkenberg Direct); Exh. No. 541TC at 37-38, 44 (Buckley Direct).
22/ PacifiCorp Initial Brief at 5.
23/ Id. at 5, n.2.
24/ Id. at 13.
25/ Id. at 15.
26/ Exh. No. 491TC at 40-42 (Falkenberg Direct); Exh. No. 522T at 4 (Falkenberg Suppl.)

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modification to ensure that Washington does not pay for the costs of resources built to serve Utah.[27] Also, if the Commission intends to adopt the Revised Protocol, ICNU has proposed minimum conditions that: 1) are consistent with the orders in other states; and 2) should address some Washington specific defects.[28] Both proposals are fully developed, long-term solutions to the jurisdictional allocation issue that do not require further study.

11 PacifiCorp criticizes Mr. Falkenberg's Pre-Merger Method, because it "is unlikely to be acceptable to other states."[29] This Commission is powerless to change ratemaking in other states, just as the other states do not set Washington rates. This does not mean, however, as the Company implies, that Washington should simply let the other states dictate the method used in Washington. Further, PacifiCorp aggressively granted concessions to other states to obtain approval of the Revised Protocol, without regard to whether it would be acceptable in Washington.

12 The fact that Washington may adopt a different allocation methodology did not stop the Utah commission from unilaterally adopting a Rolled-in method to reduce Utah's rates or prevent other states from approving their own state-specific versions of the Revised Protocol. In fact, the Company anticipated that the Revised Protocol would not be acceptable to Washington and included a provision that would

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27/ Id.
28/ Id. at 43-48.
29/ PacifiCorp Initial Brief at 15.

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ensure that the Revised Protocol would be effective in other states even if Washington adopted an alternative cost allocation methodology.[30/]

4. PacifiCorp's Utah Generation Facilities Should Be Excluded from Rates Because They Are Not Used and Useful to Washington

13 PacifiCorp inaccurately argues that the Commission has never suggested that generation from remote plants must serve Washington customers before being included in rates.[31/] In support of its argument, PacifiCorp cites a Commission decision that supports the position of ICNU, Staff, and Public Counsel that generation resources must serve and provide benefits to Washington customers.[32/] In the case cited by PacifiCorp, the Commission allowed PP&L to include a Montana plant, Colstrip 3, in rate base because Colstrip 3 was used and useful.[33/] In finding Colstrip 3 used and useful, the Commission relied upon the Washington Supreme Court's holding that the Commission can only include in rate base the fair value of utility property that "is employed for service in Washington and capable of being put to use for service in Washington."[34/] Unlike the eastern control area resources in dispute in this proceeding, Colstrip 3 could provide electric service to PP&L's customers on the west coast,[35/] and had been used to provide electricity; therefore, the Commission found that it was used and useful.[36/]

30/ Exh. No. 362 at 14-15 (Protocol) (The Revised Protocol is effective upon the ratification of Oregon, Wyoming, Idaho, and Utah.).

31/ PacifiCorp Initial Brief at 10.

32/ Id. (citing WUTC v. PP&L, Docket No. U-83-57, Second Suppl. Order (June 12, 1984)).

33/ WUTC v. PP&L, Docket No. U-83-57, Second Suppl. Order at 8-9.

34/ Id. at 9 (quoting People's Org. for Wash. Energy Resources v. WUTC, 101 Wn.2d 425 (1984)) (emphasis in original).

35/ Puget Sound Energy, Inc., 88 FERC ¶ 63,001 at 65,003-04 (July 15, 1999).

36/ WUTC v. PP&L, Docket No. U-83-57, Second Suppl. Order at 9.

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14 PacifiCorp also ignores case law that supports the conclusion that generating facilities should supply electricity or other benefits to Washington to be considered used and useful. In upholding the Commission's predecessor agency's decision to exclude costs from rates that did not serve Washington, the Washington Supreme Court explained that generating facilities outside of the state of Washington could be included in rates if they provided electricity to Washington customers.[37/] When a generating facility provides power to more than one state, the Supreme Court stated that "the just rule" is that the amount of the facility's cost that is proper to include in rate base should equal the proportionate part of the facility's electricity that is used in Washington.[38/] Although the rate base statute has been subsequently modified, the Supreme Court has relied upon this and other older cases when interpreting modern versions of the rate base statute.[39/] Thus, the Commission should continue to rely upon the principle that generating facilities must actually provide electricity or some other tangible benefit to Washington customers before being included in rates.

5. The Revised Protocol Harms Washington by Requiring Washington Customers to Subsidize the High Costs of Utah Load Growth

15 The fundamental problem with the Revised Protocol is its inequitable treatment of Washington ratepayers. PacifiCorp admits that "recent PacifiCorp resource additions have been located in Utah."[40/] Likewise, it acknowledges that Utah loads have

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37/ State ex rel. PP&L v. Dep't of Pub. Works et al., 143 Wash. 67, 82-83 (1927).
38/ Id. at 82-83.
39/ See People's Org. for Wash. Energy Resources v. WUTC, 104 Wn.2d 798 n.38, n.40 (1985) (relying upon cases from the 1920s to 1940s that interpreted the prior version of the rate base statute, including State ex rel. PP&L).
40/ PacifiCorp Initial Brief at 9.

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been growing faster than those in other states.[41] PacifiCorp attempts to explain away the apparent inequity in the Revised Protocol by arguing that as a result of the Merger, "Washington customers have enjoyed extraordinarily stable rates and have fared much better than their peers served by other Washington electric utilities."[42] That comparison is irrelevant. The correct question is whether PacifiCorp's costs are fairly allocated among the states that PacifiCorp serves. On that count, Washington ratepayers have not fared well. PacifiCorp's Utah customers have seen their rates decline, while their loads have increased substantially.[43] In comparison, Washington customers have recently experienced rate increases on an almost annual basis.

16 PacifiCorp claims that:

> [S]tudies appear to demonstrate . . . that, under the Revised Protocol, although the slower growing states in fact support a share of the cost of any new generating resources, they are simultaneously relieved of a share of existing plant costs and Company overheads. In combination, these phenomena result in revenue requirement increases in the faster-growing state that are sufficient to support the cost of new resource additions, with no subsidies.[44]

17 As shown by Mr. Falkenberg, the changing allocation factors do not adequately protect Washington from cost shifts associated with Utah load growth because they do not account for recently built generation facilities, and they rely upon inaccurate rate forecasts.[45] Another significant problem with PacifiCorp's argument is that

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[41] Id.
[42] Id. at 10.
[43] Exh. No. 764 (Staff Response to BR No. 25); Exh. No. 335 at 2 (Retail Load Growth (Firm & Non Firm MW)).
[44] PacifiCorp Initial Brief at 12.
[45] Exh. No. 491TC at 28-30 (Falkenberg Direct).

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PacifiCorp abandons the Revised Protocol and purposely breaks the linkage between lower allocators and Utah load growth to charge Washington higher rates when it comes to critical issues, such as the Production Factor adjustment, the proposed hydro deferral, or the PCAM.

18 For example, under the Production Factor adjustment, PacifiCorp uses allocators based on September 30, 2004 loads and applies them to a plant completed in 2006.[46] This gives Washington the worst of all possible worlds – loads are based on future periods (with Utah's growth causing increasing costs for the system and for Washington), but the allocators are based on the lower Utah loads from a prior period.[47] So in the end, Washington ends up with higher relative loads from a prior period, and higher costs from a future period.

B. PacifiCorp Has Failed to Demonstrate That the Commission Should Adopt Its Proposed PCAM

19 As ICNU demonstrated in its Initial Brief, PacifiCorp's PCAM proposal is fundamentally flawed. The Company claims that its proposal is similar to adjustment mechanisms in place for Avista and PSE.[48] This is not true, as Avista's ERM has a $9 million deadband, and PSE's PCAM has a $20 million deadband.[49] In both cases, the utility bears more risk and responsibility for power costs. In contrast, PacifiCorp proposes no deadband; it would shift almost all risk to customers, without any

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[46] Id. at 28-29.
[47] Id. at 9-10.
[48] See PacifiCorp Initial Brief at 15-16.
[49] Exh. No. 761 (Public Counsel Response to BR No. 23); Exh. No. 762 (Staff Response to BR No. 23).

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corresponding benefit. In addition, both the PSE and Avista mechanisms were adopted pursuant to unopposed settlement agreements.

20 Another important issue is that both the PSE and Avista mechanisms were adopted during or immediately following the energy crisis, when both utilities were facing significant credit problems. These concerns do not apply to PacifiCorp. PacifiCorp complains that it "is the only investor-owned electric utility in Washington that does not have a Commission-authorized" PCAM and that "the proposed PCAM should improve the Company's credit standing."[50/] Ironically, PacifiCorp also has the best credit rating by far of the Washington utilities, which suggests that the rating agencies are not as focused on PCAMs as PacifiCorp would have the Commission believe. The reality is that PacifiCorp has a strong credit rating without a PCAM, and it soon will have a new parent that has committed to invest substantial capital in PacifiCorp. PacifiCorp's financial condition provides no justification for the PCAM.

21 PacifiCorp also bases its PCAM arguments on the fact that "many of the components of net power costs have become highly volatile."[51/] As Mr. Falkenberg points out in his testimony, one of the drawbacks of the PacifiCorp PCAM is that it contains many costs that are not highly volatile, such as coal costs, transmission costs, QF costs, and long-term contracts.[52/] Hence, the PCAM would allow PacifiCorp to pass through costs that it can control. In addition, PacifiCorp has not explained why

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50/ PacifiCorp Initial Brief at 15-17.
51/ Id. at 16.
52/ Exh. No. 491TC at 58 (Falkenberg Direct).

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customers should bear the burden of power cost volatility when the Company has a far greater ability to control its costs than ratepayers.[53]

22 PacifiCorp also argues that "because net power cost variability is asymmetric, the Company is never made whole for its losses."[54] There is no evidence, however, of this asymmetric risk. The real issue is how actual power costs deviate from power costs included in rates, which is a symmetrical risk. The evidence in this proceeding demonstrates that actual power costs volatility since the energy crisis is far less significant than PacifiCorp alleges.[55]

C. There Is No Evidence to Support PacifiCorp's Hydro Deferral

23 The Company seeks recovery of $8.3 million of costs allegedly arising from poor water conditions in 2005.[56] PacifiCorp has provided no evidence that would support the inclusion of these costs in rates. The Company has made no showing that the financial impact of poor hydro conditions was significant enough to justify deferred accounting. Likewise, the Company has put forth no evidence of the prudence of these costs and has not even quantified the ultimate amount of the costs. Further, Mr. Buckley's proposal on the hydro deferral should be rejected because it suffers from the same problems and treats forecasted costs as if they were actual.

D. The Commission Should Adopt ICNU's WAPA Contract Adjustment

24 PacifiCorp says that, contrary "to the implication in Mr. Falkenberg's testimony, no other jurisdiction imposes a revenue adjustment for the WAPA wheeling

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[53] ICNU Initial Brief at 18-21.
[54] PacifiCorp Initial Brief at 18.
[55] E.g., Exh. No. 541TC at 188 (Buckley Direct).
[56] PacifiCorp Initial Brief at 19.

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contract."[57/] As explained in ICNU's Initial Brief, this claim is misleading.[58/] Existing precedent in both Oregon and Utah supports a disallowance.[59/] More recent Utah and Oregon decisions have not directly addressed the WAPA issue because those cases settled.[60/]

25 PacifiCorp also inaccurately claims that the Utah and Oregon commissions have abandoned the WAPA adjustment because it is too late to second guess the prudence of the contract 44 years after the contract was executed.[61/] PacifiCorp ignores the fact that the Oregon Commission adopted Mr. Falkenberg's adjustment when the contracts were approximately 40 years old.[62/] The WAPA contracts are associated with the Company's former UP&L system and could not have been considered by this Commission until a rate proceeding following the Merger. Because the Company elected to enter into stipulations that deferred issues related to its eastern control area resources and contracts in each of its rate cases following the Merger, the Commission has never affirmatively resolved the prudence of the WAPA contract.[63/] Therefore, this is the appropriate time to make an adjustment related to the WAPA contracts.

57/ Id. at 26.
58/ ICNU Initial Brief at 57-59.
59/ Re PacifiCorp, UPSC Docket No. 99-035-10, Report and Order at 23 (May 24, 2000); Re PacifiCorp, OPUC Docket No. UE 116, Order No. 01-787 at 36-38 (Sept. 7, 2001).
60/ Re PacifiCorp, OPUC Docket No. UE 170, Order No. 05-1050 (Sept. 28, 2005); Re PacifiCorp, UPSC Docket No. 04-035-42, Report and Order (Feb. 25, 2005).
61/ PacifiCorp Initial Brief at 26.
62/ Re PacifiCorp, OPUC Docket No. UE 116, Order No. 01-787 at 36-38.
63/ WUTC v. PacifiCorp, Docket No. UE-032065, Order No. 06; WUTC v. PacifiCorp, Docket No. UE-991832, Third Suppl. Order.

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E. The Company Should Not Be Permitted to Manipulate Its Test Year to Require Washington to Pay a Larger Portion of Utah Load Growth than Is Required under the Revised Protocol

26 According to PacifiCorp, "Mr. Schooley voices no objection in theory to scaling back projected power costs using the production factor, but proposes an adjustment regarding application of the production factor."[64/] PacifiCorp has adopted Mr. Schooley's adjustment and requests that the Commission "accept PacifiCorp's use of projected power costs, scaled back to the test year using the production factor."[65/] Regardless of whether Staff opposes the production factor adjustment, PacifiCorp has failed to provide sufficient evidence that would warrant its adoption. Absent from PacifiCorp's Initial Brief and testimony is any legitimate reason why PacifiCorp should be allowed to change how it has historically determined its power costs in order to shift the costs of Utah load growth to Washington customers.

F. The Commission Should Adopt ICNU's Reasonable 9.8% Return on Equity and Proposed Capital Structure

27 PacifiCorp argues that the Commission should adopt its proposed return on equity ("ROE") and capital structure because they are more consistent with national ROE averages, they are closer to the Company's actual capital structure, and traditional DCF models and consensus economists' predictions are inaccurate.[66/] PacifiCorp also claims that ICNU's ROE and capital structure proposals will cause financial harm and jeopardize the Company's credit rating.[67/] As demonstrated in ICNU's testimony and

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64/ PacifiCorp Initial Brief at 30.
65/ Id.
66/ Id. at 41-48.
67/ Id. at 46, 48.

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Initial Brief, PacifiCorp's concerns should not distract the Commission from the fact that ICNU's ROE and capital structure proposals are fair, reasonable, consistent with the financial markets, and should allow the Company to maintain its current credit rating.

28 PacifiCorp's primary argument is that ICNU's ROE recommendation should be rejected because it is lower than the national average returns allowed in other jurisdictions.[68/] PacifiCorp's ROE should not be based national averages, but upon the facts unique to its own circumstances and current market conditions. However, contrary to PacifiCorp's arguments, a review of the earnings awards in other jurisdictions provides useful corroborative evidence that the Company's 11.125% request is excessive.

29 Contrary to the assertions in PacifiCorp's Initial Brief, the recent national average ROEs establish that electric utility returns have averaged in the low 10% range.[69/] Included in these averages are numerous ROE awards at or below the 10% level.[70/] PacifiCorp also cites to the recent ROE awards issued by this Commission; however, all of these are within the national average and far closer to ICNU's recommended ROE than PacifiCorp's inflated ROE request.[71/] Essentially, recent utility commission decisions support the reasonableness of ICNU's 9.8% proposed ROE, which is slightly lower than the national average, because it reflects the particular circumstances of PacifiCorp and the recent decline in the equity markets.

68/ Id. at 45-46.

69/ Exh. No 91 at 5 (Hill Direct) (return awards have averaged 10.36% for electric utilities during the first six months of 2005); Exh. No. 27 (Authorized Electric Utility Returns) (average electric utility return of 10.41% during the time for which available data exists in 2005).

70/ Exh. No 91 at 5 (Hill Direct); Exh. No. 12 at 3 (Re PacifiCorp, OPUC Docket No. UE 170, Order No. 05-1050 at Appendix H (Sept. 28, 2005)).

71/ PacifiCorp Initial Brief at 45-46.

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30 PacifiCorp also minimizes the importance of the 10% ROE the Company recently agreed to in its last Oregon rate case.[72] Absent from PacifiCorp's discussion of the Oregon case is an acknowledgement that PacifiCorp would not have agreed to a 10% ROE if the Company did not believe the ROE was consistent with the needs of its investors. Therefore, PacifiCorp has already recognized that a 10% ROE is reasonable. The market evidence in the record in this proceeding demonstrates that a slightly lower 9.8% ROE is fair and reasonable.[73]

31 PacifiCorp asserts that an 11.125% ROE result is reasonable based on Dr. Hadaway's model runs.[74] However, as explained in Mr. Gorman's testimony and ICNU's Initial Brief, Dr. Hadaway's analyses are biased because he ignores consensus economists' projections, observable bond yields, and the current low cost equity markets.[75] PacifiCorp's Initial Brief fails to provide a legitimate basis to depart from traditional DCF analysis or to deprive ratepayers of the benefits of the current low cost capital market environment.

32 PacifiCorp also argues that the Commission should adopt its proposed capital structure because it will allegedly be closer to PacifiCorp's actual amount of common equity.[76] As explained in ICNU's testimony and Initial Brief, regardless of whether ScottishPower or Mid-American Energy Holdings Company ("MEHC") actually make the equity infusions, there has been no demonstration that the proposed equity

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72/ Id. at 45-46.
73/ ICNU Initial Brief at 29-40.
74/ PacifiCorp Initial Brief at 46-48.
75/ ICNU Initial Brief at 35-38.
76/ PacifiCorp Initial Brief at 43.

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infusions will be funded by equity capital from PacifiCorp's parent company.[77/] PacifiCorp's proposal may only increase its rate of return and claimed revenue deficiency without improving its credit rating.[78/]

33 The proposed equity infusions would also fail to enhance or support an improvement in PacifiCorp's credit rating because PacifiCorp's proposed common equity ratio is higher than ScottishPower's common equity ratio.[79/] PacifiCorp's financial risk and credit rating would not change because PacifiCorp's credit rating is based on a consolidated credit review of ScottishPower, and PacifiCorp's credit rating will not improve if its new common equity ratio is higher than its parent's.[80/]

34 PacifiCorp asserts in its Initial Brief that ScottishPower has a 54% consolidated common equity ratio that is higher than PacifiCorp's requested equity ratio.[81/] This contradicts the evidence in the record. First, PacifiCorp supports its claim with a citation to Public Counsel's supplemental testimony that relies upon an MSN website.[82/] This unverified information is contradicted by the more reliable evidence that PacifiCorp provided to Staff in discovery that demonstrates that ScottishPower's common equity ratio is 48.05%.[83/] PacifiCorp never submitted any evidence changing or refuting this information, which was relied upon and attached to Mr. Gorman's direct

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77/ ICNU Initial Brief at 29-32.
78/ Id.
79/ Exh. No. 121T at 9-13 (Gorman Direct).
80/ Id.
81/ PacifiCorp Initial Brief at 43.
82/ Id.; Exh. No. 114 at 5 (Hill Suppl.).
83/ Exh. No. 137 at 2 (PacifiCorp Response to Staff Data Request ("DR") No. 87).

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testimony.[84] Thus, the evidence demonstrates that PacifiCorp's equity ratio would be higher than its parent's, and the Company's financial risk and credit rating would not change if the $500 million equity infusion occurs, because the overall debt ratio and leverage risk is not changing.[85]

35 Finally, PacifiCorp claims that ICNU's proposed capital structure and ROE will jeopardize PacifiCorp's credit rating.[86] Relying upon Mr. Williams' analysis, PacifiCorp asserts that ICNU's proposals would produce low credit metrics that could harm the Company's bond ratings.[87] Mr. Williams' interpretation of the credit metric financial ratios is flawed because he did not accurately identify that the Company's actual secured rating is "A-" and its unsecured credit rating is "BBB+."[88] Identifying both ratings is critical in this analysis because, in the construction of these ratios, Mr. Williams included $520 million of purchased power agreement debt equivalents.[89] These are unsecured debt obligations and should not be included in determining PacifiCorp's secured debt rating. A correct interpretation of the credit metric financial ratios demonstrates that ICNU's proposed ROE and capital structure will support PacifiCorp's current "A-" secured credit rating and its "BBB+" unsecured rating.[90]

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[84] Exh. No. 121T at 10 (Gorman Direct); Exh. No. 137 at 2 (PacifiCorp Response to Staff DR No. 87).
[85] Exh. No. 121T at 9-13 (Gorman Direct).
[86] PacifiCorp Initial Brief at 41, 46, 48.
[87] Id. at 46.
[88] See TR. at 1658: 12-14 (Gorman); Exh. No. 139 at 1 (S&P Credit Ratings Report).
[89] Exh. No. 66T at 15 (Williams Rebuttal); TR. at 1658: 4 – 1659: 5 (Gorman).
[90] TR. at 1658: 4 – 1659: 5 (Gorman).

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G. The Failure to Make ICNU's Tax Adjustment Will Provide PacifiCorp's Parent Company with Excessive Returns

36 PacifiCorp makes two new arguments in its Initial Brief in opposition to ICNU's proposal that the Company should not collect income tax expense from ratepayers that is never paid to taxing authorities. First, PacifiCorp argues that ICNU's proposed tax adjustment will be moot because of the MEHC acquisition of PacifiCorp.[91] This is an interesting argument since PacifiCorp has strongly argued in this proceeding that the MEHC impacts are not known and measurable. Second, the Company argues that the tax adjustment should not be made because ScottishPower did not make as much money on its investment as it originally intended.[92] These spurious arguments should not distract the Commission from the fact that, if a tax adjustment is not made, then income taxes paid by ratepayers will not be passed on to the taxing authorities, but will be retained by PacifiCorp's shareholders.

37 Contrary to PacifiCorp's assertions, ICNU's tax adjustment will not become "moot" if MEHC acquires PacifiCorp. Although all parties recognize that MEHC will likely acquire PacifiCorp during the period in which rates will be in effect, many elements of PacifiCorp's base rates assume continued ScottishPower ownership. For example, all parties have agreed that the Company's rates will include charges from ScottishPower for corporate services.[93] This is proper because, while PacifiCorp's

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[91] PacifiCorp Brief at 49.
[92] Id. at 51.
[93] PacifiCorp Brief at 31-32; Exh. No. 744 (ICNU Response to Commission BR No.12).

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owner will change, its rates should to continue to reflect that the Company will continue to be owned by a corporate parent that is expected to provide similar services.

38 The evidence demonstrates that MEHC, like ScottishPower, will be able to file a consolidated tax return and retain for shareholders the income taxes paid by ratepayers. MEHC has a consolidated capital structure and files a consolidated tax return that will provide a high level of debt leverage to create a similar tax benefit as the one that exists for ScottishPower.[94] While ICNU was not provided sufficient information in discovery to properly calculate the exact amount of a tax adjustment once MEHC acquires PacifiCorp, the only evidence in the record on this issue demonstrates that a tax adjustment should be made.[95] Similar to numerous other revenue requirement issues like the ScottishPower cross charges, the tax adjustment should be made even if MEHC acquires PacifiCorp.[96]

39 PacifiCorp also asserts that it should be permitted to retain the amounts ratepayers pay as income taxes because ScottishPower has allegedly "done poorly on its PacifiCorp investment."[97] PacifiCorp's argument confuses the issue by asserting that the tax adjustment should not be made because ScottishPower infused equity into

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[94] See Exh. No. 114 at 5 (Hill Suppl.); Exh. No. 821T at 3-4 (Selecky Suppl.).

[95] Exh. No. 821T at 3-4 (Selecky Suppl.). Although PacifiCorp had an opportunity to submit evidence on this issue, PacifiCorp did not submit any testimony or other evidence that contradicted Mr. Selecky's unequivocal testimony that MEHC files a consolidated return and that a tax adjustment should be made if MEHC acquires PacifiCorp. In addition, while PacifiCorp proposed an alternative tax adjustment based on ScottishPower's consolidated tax returns, PacifiCorp did not provide any evidence regarding an alternative tax adjustment based on MEHC ownership.

[96] See Exh. No. 821T at 3-4 (Selecky Suppl.).

[97] PacifiCorp Brief at 51.

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PacifiCorp.[98] Any capital that was infused into PacifiCorp was to support additional investment and is unrelated to determining the amount of taxes to be included in the Company's revenue requirement. In addition, it is illegal for PacifiCorp to charge ratepayers costs it does not actually incur merely because its overall financial performance may have been "poor." Allowing PacifiCorp to collect higher rates in this proceeding because of poor past financial performance is the classic evil that is prohibited by the rule against retroactive ratemaking[99] and would violate the principle that the Company should only recover those costs that are expected to be incurred to provide service to customers.

H. PacifiCorp's RTO Costs Should Be Excluded from Rates

40 PacifiCorp asserts that it should be permitted to recover its RTO costs based on the false argument that the Federal Energy Regulatory Commission ("FERC") requires RTO participation.[100] Specifically, PacifiCorp argues that FERC Order 2000 requires RTO participation.[101] PacifiCorp knows this statement is false, as the Company recently received guidance from FERC that its current RTO proposal (Grid West) "does not have to satisfy the requirements of Order No. 2000 . . . ."[102] As PacifiCorp is well aware, FERC has backed away from Order 2000 and has held that it will "not require Grid West to meet the requirement of Order No. 2000."[103] In addition, there is no

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[98] Id.

[99] See, e.g., Re Puget Sound Energy, Docket No. UE-010410, Order Denying Petition to Amend Accounting Order at ¶¶ 7-8 (Nov. 9, 2001).

[100] PacifiCorp Initial Brief at 24-25.

[101] Id.

[102] Bonneville Power Admin et al., 112 FERC ¶ 61,012, mimeo at 14, 18 (July 1, 2005).

[103] Id.

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evidence to support PacifiCorp's allegation that it will continue to spend excessive amounts on RTO formation costs if the Company ceased participating in the current efforts by Grid West to develop an east-side RTO.

I. ICNU Agrees with the PacifiCorp/Staff ScottishPower Cross Charge Adjustment

41 In its Initial Brief, PacifiCorp argues that the Commission should reject ICNU's ScottishPower cross charge adjustment in favor of Staff's corresponding adjustment, which PacifiCorp has agreed to.[104] As ICNU identified in response to Commission BR No. 12, there is no dispute on this issue because "ICNU is no longer proposing its adjustment related to ScottishPower cross charges. ICNU accepts the proposed [Staff] adjustment related to ScottishPower cross charges agreed to by PacifiCorp in Paul Wrigley's rebuttal testimony."[105]

III. CONCLUSION

42 The record in this proceeding demonstrates that the Commission should order PacifiCorp to significantly reduce its rates. The Company has not met its burden of proof to establish that Washington ratepayers should be charged income taxes that are never paid to the taxing authorities, the imprudent costs of the WAPA contracts, or be required to fund the Company's unnecessary and/or inflated RTO, incentive, medical, pension, and retirement benefit costs. PacifiCorp has also failed to demonstrate that traditional ROE and cost of capital analysis should be abandoned in order to inflate the Company's earnings. The Commission should modify the Revised Protocol and reject

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104/ PacifiCorp Initial Brief at 31-32.
105/ Exh. No. 744 (ICNU Response to Commission BR No.12).

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the production factor adjustment because ratepayers should not be required to pay for the costs of high-cost resources that are built to serve Utah. Finally, the Commission should reject the Company's PCAM and hydro deferral because the Company has failed to present sufficient evidence that either proposal is necessary or would benefit ratepayers.

Dated this 6th day of March, 2006.

Respectfully submitted,

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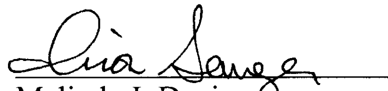

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