[Service Date July 14, 2006]

BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PACIFICORP d/b/a PACIFIC POWER & LIGHT COMPANY Respondent.	)	DOCKET UE-050684 ORDER 06 ORDER DENYING PACIFICORP'S PETITION FOR RECONSIDERATION; CLARIFYING PORTIONS OF ORDER 04
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 UE-050412 ORDER 05 ORDER DENYING STAFF'S PETITION FOR RECONSIDERATION; CLARIFYING PORTION OF ORDER 03
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PACIFICORP d/b/a PACIFIC POWER & LIGHT COMPANY Respondent.	)	DOCKET UE-060669 ORDER 02 ORDER REJECTING TARIFF REVISIONS

1 ***Synopsis.*** *We deny PacifiCorp's petition for reconsideration, rejecting the Company's arguments that we erroneously applied the used and useful statute to reject its allocation method, or that the "end result" of our decision is so unfair as to be unconstitutional.*

2 *We clarify certain factual errors, but find them not material to our decision. We also find our decisions in prior PacifiCorp rate cases do not establish a precedent for granting rate relief in the absence of an agreed-upon cost allocation method. We reject the Company's request for rate relief, both in the Company's petition for reconsideration and in the separate request for a 2.99 percent rate increase, finding the record does not justify relief. Finally, we deny Staff's petition for reconsideration, but clarify that Staff may raise the issue of risk sharing when the Company seeks recovery in rates of deferred excess power costs.*

SUMMARY

3 **Proceedings.** In Docket UE-050684, PacifiCorp d/b/a Pacific Power & Light Company (PacifiCorp or the Company) filed with the Washington Utilities and Transportation Commission (Commission) revisions to its tariffs, proposing an increase in annual revenues from Washington operations of $39.2 million, resulting in a proposed uniform increase in rates of 17.9 percent.[1]

4 In Docket UE-050412 the Company requested authority to establish deferral accounting related to the effect of low river flows on its hydroelectric-based cost of power.

5 The Company filed revisions to its tariffs in Docket UE-060669, proposing a rate rider surcharge imposing an increase in annual revenues from Washington operations

[1] The Company later reduced its requested rate increase to $29.8 million.

of $7 million, resulting in a proposed rate increase of 2.99 percent across all customer classes.

6 **Parties.** James M. Van Nostrand, Marcus Wood and Jason B. Keyes, Stoel Rives LLP, Portland, Oregon, and Seattle, Washington, represent PacifiCorp. Melinda J. Davison and Irion Sanger, Davison Van Cleve, P.C., Portland, Oregon, represent Industrial Customers of Northwest Utilities (ICNU). Brad M. Purdy, attorney, Boise, Idaho, represents The Energy Project. Ralph Cavanagh, Northwest Project Director, Natural Resources Defense Council (NRDC), San Francisco, California, represents the NRDC. Simon ffitch and Judith Krebs, Assistant Attorneys General, Seattle, Washington, represent the Public Counsel Section of the Washington Office of the Attorney General (Public Counsel). Donald T. Trotter, Assistant Attorney General, Olympia, Washington, represents the Commission's regulatory staff (Commission Staff or Staff).

7 **Procedural History.** In June 2005, the Commission consolidated Dockets UE-050684 and UE-050412 for hearing and determination under WAC 480-07-320. After considering evidence presented in hearings in January and February 2006 and the parties' post-hearing briefs, the Commission entered a final order on April 17, 2006, resolving the contested issues.

8 On April 27, 2006, the Company and Commission Staff filed petitions for reconsideration of the final order. On the same day, the Company filed an application to increase rates by 2.99 percent through a rate rider surcharge in Docket UE-060669, relying on the record evidence in consolidated Dockets UE-050684 and UE-050412 for support. The Company also filed a motion to consolidate the new tariff filing with the other consolidated dockets.

9 At the Commission's request, the parties on June 16, 2006, filed responses to the pending petitions for reconsideration and the Company's motion to consolidate. ICNU, Public Counsel, the Energy Project and Commission Staff filed comments by

June 23 concerning the 2.99 percent tariff filing. The Company filed its rebuttal to these comments on June 26.

10 The Commission issued a notice on June 23, 2006, advising the parties in consolidated Dockets UE-050684 and UE-050412 that it would enter an order on the pending petitions for reconsideration by July 12, 2006.

11 After hearing from interested persons during the Commission's June 28, 2006, open meeting, the Commission entered an order suspending the tariff filing in Docket UE-060669 and consolidating the filing with consolidated Dockets UE-050684 and UE-050412.

12 **The Final Order.** In the final order in consolidated Dockets UE-050684 and UE-050412, captioned Order 04 in Docket UE-050684 and Order 03 in UE-050412 (Order), the Commission determined that PacifiCorp did not meet its burden to prove its proposed rates were fair, just and reasonable. The Commission rejected the Company's Revised Protocol inter-jurisdictional cost allocation method, on which the Company based its request for increased rates.[2] The Commission found the Company failed to prove that the resources included in the Revised Protocol are used and useful in this state, as required by RCW 80.04.250. In the absence of an acceptable allocation methodology and with no viable alternative in the record for establishing new rates, the Commission found the Company's existing rates, determined in a recent proceeding, remain fair, just, reasonable and sufficient.

13 The Commission also rejected the Company's proposed power cost adjustment and decoupling mechanisms due to the lack of an appropriate allocation method. We provided guidance on certain contested adjustments involving matters of policy, accounting rules and theory, and allowed the Company to establish deferral accounts

[2] PacifiCorp provides retail electric service in six states: Utah, Oregon, Idaho, Wyoming, California and Washington. The Revised Protocol is PacifiCorp's proposed method or plan for

for costs relating to declining hydroelectric generation. The Commission also established an overall cost of capital for the Company of 8.10 percent (10.2 percent return on equity), rejecting proposals for a double-leverage adjustment to the cost of capital.

MEMORANDUM

A. PacifiCorp's Petition for Reconsideration

14 PacifiCorp presents three arguments for reconsideration. First, the Company asserts the Order erroneously interprets and applies RCW 80.04.250, the used and useful statute. Second, it asserts that alleged errors of fact and the failure to consider relevant evidence should change the result of applying the statute. Third, it argues that even if the statute has been correctly applied, the "end result" of no rate increase at all is unconstitutional.

1. Interpretation of RCW 80.04.250 — the Used and Useful Statute

15 Our Order rejected the Company's Revised Protocol method of allocating inter-jurisdictional costs to Washington, finding "PacifiCorp has not met its burden of proof to show that resources allocated to Washington in the Revised Protocol are 'used and useful for service in this state' or that the Revised Protocol meets statutory standards."[3] We said:

> Under our governing statutes, we must find a resource to be used and useful in this state before its costs [Footnote omitted] may be recovered in rates. We interpret the phrase "used and useful for service in this state" to mean benefits to ratepayers in Washington, either directly (e.g., flow of power from a resource to customers) and/or indirectly

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allocating costs and wholesale revenues associated with the Company's generation, transmission and distribution system across its six-state service territory for the purpose of setting retail rates.

[3] Order, ¶ 49.

> (e.g., reduction of cost to Washington customers through exchange contracts or other tangible or intangible benefits).[4]

16 We further held that the Company must demonstrate "that resources in its Eastern service territories, remote from Washington, provide *tangible and quantifiable benefits to customers 'in this state'* as required by RCW 80.04.250,"[5] and that "[t]he test for including a resource in rates is not whether it is 'needed, deliverable and least cost' but rather *whether it provides quantifiable direct or indirect benefits to Washington commensurate with its cost*."[6]

17 PacifiCorp seeks reconsideration of our finding that property included in rate base must "provide tangible and quantifiable benefits to customers" and that quantifiable direct or indirect benefits be "commensurate with" the cost of the property.[7] The Company asserts our finding conflicts with the plain language of the statute, Washington Supreme Court precedent and prior Commission decisions, resulting in "an outcome that is fundamentally unfair on its face."[8] Specifically, the Company asserts that we interpret the term "for service" in RCW 80.04.250 too narrowly, contrary to statutory direction that the term "service" is "used in its broadest and most inclusive sense."[9]

18 PacifiCorp asserts the supreme court rejected a narrow interpretation of the used and useful statute in *State ex. rel. Pac. Tel. & Tel. Co. v. Department of Pub. Serv*., (*Pacific Telephone)*,[10] holding that property held for future use or property used to serve multiple jurisdictions cannot simply be removed from rate base. Rather, it says the portion used for Washington service must be allocated to Washington

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[4] *Id*., ¶ 50.
[5] *Id*., ¶ 62 (emphasis added).
[6] *Id*., ¶ 68 (emphasis added).
[7] PacifiCorp Petition, ¶ 5.
[8] *Id*., ¶¶ 1-2.
[9] *Id*., ¶ 5, quoting RCW 80.04.010.
[10] 19 Wn.2d 200, 142 P.2d 498 (1943).

customers.[11] PacifiCorp also relies on the court's interpretation of the used and useful statute in *People's Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission*, (*POWER I)*[12] and the subsequent legislative action allowing construction work in progress (CWIP) in rate base upon a "public interest" finding to assert that our interpretation of the used and useful statute is too narrow and restrictive.[13]

19 PacifiCorp asserts that our interpretation of the used and useful statute conflicts with prior Commission decisions regarding facilities located outside Washington, specifically the decision in Cause No. U-83-57 that the Colstrip 3 generating plant was used and useful to Washington ratepayers, and the decision in an Avista Utilities rate case in Docket UE-050482 to include the Coyote Springs II facility in rate base.[14] PacifiCorp complains the Commission has never before used "the remoteness of a plant's location" as the basis for rejecting its costs in rate base or for rejecting rate relief.[15] The Company asserts the Commission has never before required that resources provide "tangible and quantifiable benefits to Washington customers" before inclusion in rate base. PacifiCorp also claims that other states do not rigidly apply the used and useful standard to multi-state utilities to exclude from rates out-of-state resources.[16]

20 Finally, PacifiCorp asserts it was "fundamentally unfair" to include in the Order a finding that the Company "accepted the risk that divergent allocation decisions among the states might result in under-recovery."[17] PacifiCorp asserts the commitment we referred to was made 16 years ago in connection with Oregon's approval of the merger between Pacific Power and Light Company (Pacific Power)

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[11] PacifiCorp Petition, ¶ 6, citing 19 Wn.2d at 230.
[12] 101 Wn.2d 425, 430, 679 P.2d 922 (1984).
[13] PacifiCorp Petition, ¶ 7.
[14] *Id.*, ¶¶ 8-10.
[15] *Id.*, ¶ 9.
[16] *Id.*, ¶ 11.
[17] *Id.*, ¶ 12, citing Order, ¶ 56.

and Utah Power and Light Company (Utah), and should not suggest that the Company agreed to accept the risk that no allocation method would be adopted by a jurisdiction.[18] PacifiCorp asserts that the discussion is irrelevant to the finding that the Company has failed to meet its burden of proof in this proceeding.[19]

21 In response, Staff, Public Counsel and ICNU argue that our interpretation and application of the used and useful statute is correct.[20]

22 ***Discussion and Decision.*** While the Commission has "broad generalized powers in rate setting matters," it "must act strictly within its statutory authority, within constitutional limitations, and in a lawful manner."[21] Our decision to reject the Revised Protocol is based on the statutory direction for valuing public service property for rate making purposes and the Company's failure to meet its burden of proof.

23 The statute at issue, RCW 80.04.250, provides:

> The commission shall have power upon complaint or upon its own motion to ascertain and determine the fair value for rate making purposes of the property of any public service company *used and useful for service in this state* and shall exercise such power whenever it shall deem such valuation or determination necessary or proper under any of the provisions of this title.[22]

24 We rejected the Revised Protocol and the Company's tariffs because the Company had not proven that Eastside resources provide benefit to Washington customers, not

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[18] *Id.*, ¶ 14.
[19] *Id.*, ¶ 15.
[20] Staff Response, ¶¶ 13-58; Public Counsel Response, ¶¶ 4-10; ICNU Response, ¶¶ 5-15.
[21] *Jewell v. Utils. and Transp. Comm'n,* 90 Wn.2d 775, 776-777, 585 P.2d 1167 (1978); *see also Pacific Telephone*, 19 Wn.2d at 215.
[22] RCW 80.04.250 (emphasis added).

simply because the resources are remote from Washington.[23] Our supreme court in 1927 upheld the Commission's application of a prior version of the used and useful statute to exclude certain resource costs from the Company's rate base because the resources, located in Oregon, did not serve Washington customers.[24]

25 The cases PacifiCorp relies on to discredit our analysis actually support it. In *Pacific Telephone*, the court determined that a resource may not be excluded from rate base because it is not exclusively dedicated to Washington, but that Washington's share of the costs must be resolved through an allocation process.[25] The court found that property held for future use should be included in rate base, as it will be used in the company's business "before long," implying a use beneficial to customers.[26] Proving the beneficial use, if any, to Washington's ratepayers of PacifiCorp's remote resources and the fair allocation of those benefits and costs are precisely the issues upon which PacifiCorp's case founders.

26 In *POWER I,* the court distinguished and limited the application of the *Pacific Telephone* decision, criticizing the decision for failing "to ground its decision upon any analysis of the controlling statute."[27] The court interpreted the language of RCW 80.04.250 at issue here:

> Used is defined as "employed in accomplishing something"; "useful" is defined as capable of being put to use: having utility: advantageous: producing or having the power to produce good: serviceable for a beneficial end or object.[28]

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[23] Order, ¶ 53.
[24] *State ex rel. Pacific Power & Light Co. v. Dep't of Pub. Works et al.*, 143 Wn. 67, 254 P. 839 (1927) [Hereinafter *Pacific Power*].
[25] *Pacific Telephone*, 19 Wn.2d at 229-30.
[26] *Id.* at 229.
[27] *POWER I*, 101 Wn.2d at 432.
[28] *Id.* at 430, quoting Webster's 3rd New Int'l Dictionary at 2524 (1976).

27 Both common sense and hornbook utility law support our conclusion that RCW 80.04.250 requires a resource to be "employed in accomplishing something … beneficial" for Washington ratepayers ("in this state"), before they can be required to pay for it.[29] Our Order allows these benefits to be direct or indirect, tangible or intangible, as long as they are reasonably quantifiable and commensurate with their costs.

28 As Staff correctly notes:

> In *POWER I*, the court held that RCW 80.04.250 excluded construction work in progress ("CWIP") from rate base because "an uncompleted facility provides no service whatsoever." [Footnote omitted] It directly follows that RCW 80.04.250 also excludes from rate base a completed, operational facility that provides no benefits to Washington ratepayers.[30]

That the legislature subsequently amended the statute to provide a specific exception for CWIP confirms the proposition that "used and useful" requires proof of some benefit before ratepayers pay for an asset.

29 PacifiCorp counters that because RCW 80.04.010 provides that "[t]he term 'service' is used in this title in its broadest and most inclusive sense," we erred in requiring proof of some benefit to Washington customers. The general definition of "service" in RCW 80.04.010 does not trump the clear import of that term in the context of RCW 80.04.250. To paraphrase *POWER I*, no benefit is no service whatsoever. By allowing the benefit to be direct or indirect, tangible or intangible, we have given the term "'service' … its broadest and most inclusive sense," if RCW 80.04.250 is to have any sense at all.

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[29] Goodman, *The Process of Ratemaking* (1998) at 800; 73 C.J.S. Public Utilities § 46 (2005).
[30] Staff Response, ¶ 20.

30 Our decision today is consistent with decisions reached in prior cases. Contrary to the Company's assertions, the Commission's decision in Cause U-83-57 to include in rate base a portion of the Colstrip 3 facility, located in Montana, was based on testimony that power from Colstrip 3 could be transmitted to the Western portion of the Company's system.[31] The Commission reduced the Colstrip 3 related costs to reflect the fact that a substantial portion of the plant's output was already committed elsewhere under a 40-year power sales contract. In sum, the Commission determined there was a quantifiable benefit available to Washington from Colstrip 3 and then allocated the costs commensurate with that benefit.

31 Similarly, our recent decision in Avista Dockets UE-050482 and UE-050483 to include in rate base the second half of the Coyote Springs II project located near Hermiston, Oregon, is consistent with our decision here.[32] Witnesses in that case provided record testimony demonstrating the benefits through direct transmission of power from the facility to Washington.[33]

32 Finally, as to PacifiCorp's allegation of the Commission's "long-standing" use of a "rolled-in" allocation method, we note that the Commission approved in Cause U-86-02 a consensus of the parties that ended when Pacific Power merged with Utah Power in 1988. Since then, there has been no consensus and no allocation methodology adopted by the Commission.[34]

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[31] *See* Staff Response, ¶ 47; Appendix 1, *WUTC v. Pacific Power and Light Co*., Cause U-83-57, TR 38:1 – 40:23 (Steinberg) (1984); *see also* ICNU Response, ¶ 13.
[32] *See* Staff Response, ¶ 53.
[33] *See* Appendix 2 to Staff Response*, WUTC v. Avista Utilities*, Dockets UE-050482 and UE-050483, Exh. 81, 25:22 – 26:19 (Peterson); Appendix 3, *WUTC v. Avista Utilities*, Dockets UE-050482 and UE-050483, Exh. 1, 21-24 (McIntosh).
[34] The Company's argument that our decision to deny rate relief is inconsistent with the Commission's prior decisions fails. *See* PacifiCorp Petition, ¶ 34. None of the cases PacifiCorp cites stand for the proposition that the Company is entitled to rate relief if the parties cannot agree on an allocation method. In every case, the Company bears the burden of showing its request for a rate increase is fair, just and reasonable. *See* RCW 80.04.130. If the parties do not reach settlement on a particular matter, the Company still bears the burden of proof. This case is no exception.

33 It is this very point that led us to remind the Company of commitments it made in Oregon and Washington to accept "the risk that divergent allocation decisions among the states might result in under-recovery."[35] These commitments were not the basis for rejecting the Revised Protocol or rate relief. Rather, our purpose was to anticipate and respond to the very argument that the Company now makes that our decision is "fundamentally unfair." There is nothing "unfair" about reminding the Company of issues identified and commitments made 16 years ago. Nor is there anything unfair about requiring the Company to meet its statutory burden of proof. Indeed, it would be fundamentally unfair to Washington ratepayers to pay for resources that the Company has not proven benefit them, as required by RCW 80.04.250.[36]

2. Misstatements of and Failure to Consider Evidence

34 PacifiCorp asserts that even assuming our interpretation of the used and useful statute is correct, the evidence in the record demonstrates that the Company's resources should be included in rate base, i.e., that the Revised Protocol should be accepted.[37] PacifiCorp asserts that the Order does not fairly characterize the evidentiary record, particularly where the Order states that the Company failed to provide "quantitative evidence of the benefits" that its integrated system provides to Washington customers or that the Company relied on "unsubstantiated broad statements."[38]

35 The Order states that PacifiCorp may demonstrate that its resources provide benefit to Washington customers "through historical system operation or modeling of the system showing that Eastside plant costs added to Washington rates would be offset

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[35] Order, ¶ 56.
[36] The purpose and policy behind the statutory requirement is reflected in the anomaly which the Company has not yet explained: "Since the merger of Pacific Power and Utah Power, the rates for Utah customers have decreased while the rates for Washington customers have increased, despite a rapid increase in demand in Utah and substantial investments in Utah to serve that demand." Order, n.85, citing Exh. 764, Tables 1 and 2; Exh. 765.
[37] PacifiCorp Petition, ¶ 35.

by reductions to other cost categories (e.g., power costs), such that overall costs to Washington ratepayers would be no more than without the Eastside resources."[39] The Company asserts the testimony of Mr. Duvall and Mr. Taylor provides information sufficient to meet this test and demonstrate the Washington-specific benefits of Eastside resources.[40]

36 The Company also asserts that the Order contains a number of inaccuracies related to the inter-jurisdictional allocation method. First, the Company asserts that footnote 10 on page 10 "erroneously states that the former Pacific Power states and resources are all part of the Western control area."[41] The Company states that "Wyoming loads and two large Pacific Power thermal resources (Dave Johnston and Wyodak) are located in the *Eastern* control area."[42]

37 Second, the Company asserts that paragraph 26 "refers to 'a number of material conditions or modifications' that were imposed by the other states in adopting the Revised Protocol." It says that "none of the conditions imposed by the states relate to the essential features of the Revised Protocol, but rather are transitional matters that limit the rate impact."[43] PacifiCorp asserts that to suggest that these conditions indicate the lack of a lasting consensus "unfairly maligns" the efforts of other states to resolve the allocation issue.[44]

38 Third, the Company asserts the Order "erroneously refers to the Hybrid Model as a 'prior allocation method'" and "states that 'Oregon reserved the right to adopt the Hybrid Model if the results of the Hybrid Model proved more favorable to Oregon

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[38] *Id.*, ¶ 36, quoting Order, ¶ 53.
[39] Order, ¶ 69.
[40] PacifiCorp Petition, ¶ 36, citing Exhs. 331T, 332-340 (Duvall), specifically Exh. 331T at 38:1-19 (Duvall); Exh. 371T at 10:14-23 (Taylor).
[41] *Id.* ¶ 37.
[42] *Id.* ¶ 37, citing Exh. 331T at 34:18-26 (Duvall).
[43] *Id.* ¶ 37.
[44] *Id.*

ratepayers'."[45] The Company asserts that no commission has ever used the Hybrid Model for setting rates, and that there is no such statement in the Oregon order. The Company asserts the Oregon order discusses using the Hybrid Model for comparison and includes it as a "structural protection option."

39 Fourth, the Company says the Order "erroneously states that the Company did 'not quantify other benefits of an integrated system'."[46] The Company points to the following evidence in the record:

- The South Idaho Exchange contract annually "moves 800,000 MWhs from the Eastern System to the Western System."[47]
- The overall benefits of an integrated system were quantified at $59 million at the time of the 1989 merger.[48]
- Integration of the system provided approximately $300 million worth of value and that Washington customers received about 14 percent of the benefits, although they were eight percent of the system. [49]

40 Finally, the Company asserts that by expecting it "to include the full value of hydro-electric resources in the Western control area in any inter-jurisdictional cost allocation model it develops for Washington" the Commission overlooks that Wyoming customers have supported the costs of hydroelectric resources as long as Washington customers have, and that "it would be inequitable not to recognize their right to the benefits of these resources."[50]

41 ***Discussion and Decision.*** We deny PacifiCorp's petition for reconsideration on the basis of alleged misstatements or failure to consider evidence. First, the evidence

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[45] *Id*.
[46] *Id*., quoting Order, ¶ 36.
[47] *Id*., citing Exh. 331T at 13:13-14 (Duvall).
[48] *Id*., citing Exh. 331T at 35:18-23 (Duvall).
[49] *Id*., citing TR 343:12-24; 429:18 – 430:15 (MacRitchie).
[50] *Id*., quoting Order, ¶ 70.

upon which PacifiCorp relies as support for the Revised Protocol is insufficient. Although Mr. Duvall and Mr. Taylor discussed in their testimony the possible benefits to Washington from the merger and the Company's system, neither quantified the alleged benefits or provided adequate support for the stated benefits sufficient to justify approval of the Revised Protocol. As Staff aptly describes, the other evidence the Company relied on to quantify the benefits of an integrated system – the South Idaho Exchange contract, merger benefits and an unsupported reference by Mr. MacRitchie to a study not in the record – are not sufficient to justify including all Eastside resources into rate base. Nothing in PacifiCorp's petition alters our conclusion that PacifiCorp failed to prove its new Eastern control area resources benefit Washington ratepayers to the degree reflected in the Revised Protocol.

42 We clarify in this order that the Wyoming coal plants are located in the Eastern, not the Western, control area and that the term "full value" when applied to hydroelectric facilities does not mean *all* of the benefits, but those fairly allocable to Washington. While we correct and clarify these misstatements in the Order, we find them immaterial to our ultimate decision.

43 PacifiCorp objects to our characterization of the terms upon which other states adopted the Revised Protocol and whether the effect of the terms indicates a lasting consensus. The Company is entitled to disagree with our reasonable inferences from the record, but the statements do not rise to the level of error that changes the result. The same is true for PacifiCorp's objection to certain statements in the Order about the Hybrid Model.

44 There may be, as PacifiCorp states, demonstrable benefits to Washington State, but none of the issues the Company identifies as errors or misstatements detracts from our conclusion that the Revised Protocol does not adequately support or meet the statutory requirement that resources be "used and useful in this state."

3. Violation of Constitutional Ratemaking Standards

45 PacifiCorp argues that the Commission's denial of any rate relief violates the "end results" test under *Federal Power Commission v. Hope Natural Gase,*[51] *i.e.*, the rate level violates the Fifth Amendment prohibition against takings without compensation. In *Hope*, the U.S. Supreme Court held:

> [T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its ratemaking function, moreover, involves the making of "pragmatic adjustments." … Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling. [Citations omitted] *It is not the theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.* The fact that the method employed to reach that result may contain infirmities is not then important.[52]

46 PacifiCorp asserts that our Order fails to meet this constitutional requirement because applying the used and useful statute as an absolute bar to rate relief is a "formulaic, inflexible approach to ratemaking" that the Supreme Court rejected in the "end results" test.[53] PacifiCorp also asserts the Order does not reach the analysis required under *Hope* to "evaluate the overall impact of the Order on the Company's financial health or ability to access capital on reasonable terms."[54]

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[51] 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944).
[52] 320 U.S. at 602 (emphasis added).
[53] PacifiCorp Petition, ¶ 17.
[54] *Id.*, ¶ 16.

47 PacifiCorp relies on a D.C. Circuit court decision, *Jersey Central Power & Light v. FERC*,[55] as support for the proposition that relying on the used and useful standard as a bar to rate relief may violate the "end results" test. In that case, the Federal Energy Regulatory Commission (FERC) relied on Jersey Central's testimony and evidence and decided without a hearing to exclude from rate base a portion of the Company's cancelled investment in a nuclear plant, saying that the investment violated FERC's non-statutory used and useful standard. The Company included in testimony evidence of its financial difficulties, but FERC denied recovery without analysis or discussion.[56] FERC also denied the Company's request for rehearing to address the issue of the Company's financial situation.[57] The court found FERC's decision did not meet the "end results" test because it used the used and useful standard as an "impregnable barrier" to rate relief.

48 The Company also relies on the state supreme court's decision in *People's Org. for Wash. Energy Res. v. Wash. Util. and Transp. Comm'n (POWER II)*,[58] U.S. Supreme Court decisions in *Duquesne Light Co. v. Barasch*[59] and *Permian Basin Area Rate Cases*,[60] and a Michigan commission decision to support its arguments.

49 PacifiCorp asserts that the Order does not include the required analysis that the resulting rate is just and reasonable, and argues that the record demonstrates that rate relief "in some magnitude" is warranted.[61] PacifiCorp evaluates the revenue requirement adjustments proposed by all the parties, and after including the adjustments it assumes the Commission would have adopted, proposes an average rate increase of $11 million.[62] Alternatively, the Company proposes the Commission

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[55] 810 F.2d 1168 (D.C. Cir. 1987).
[56] 810 F.2d at 1172.
[57] *Id*. at 1172-73.
[58] 104 Wn.2d 798, 811, 711 P.2d 319 (1985).
[59] 488 U.S. 299, 109 S.Ct. 609, 102 L.Ed. 646 (1989).
[60] 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed. 312 (1968).
[61] PacifiCorp Petition, ¶ 21.
[62] *Id.* Tables 1 and 2. In Table 2, the Company averages the recommendations of the Company, Commission Staff, ICNU and Public Counsel after accounting for items decided in the Order.

could grant rate relief based on distribution costs in Washington, which are treated as *situs* and not affected by the allocation method.[63]

50 ***Discussion and Decision.*** As we discuss above, the Commission, in exercising its broad rate setting authority, "must act strictly within its statutory authority, within constitutional limitations, and in a lawful manner."[64] Our statutory mandate is to set fair, just, reasonable and sufficient rates, balancing the interests of ratepayers and the Company and its investors.[65] There are certain constitutional limits to our ratemaking authority.[66]

51 In *POWER II*, the Washington Supreme Court summarized our constitutional boundaries:

> [R]ates, no matter how they are determined, need only "enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate investors for the risks assumed …" [Citing *Hope*] That test was given further content in the *Permian Basin Area Rate Cases*, [Citations omitted], which held that a regulatory agency's rate decision would be affirmed if it fell within the "*zone of reasonableness*." [Citations omitted][67]

PacifiCorp asserts this results in an $8.2 million increase in revenue requirement and an $11 million increase if resolution of issues inferred from the Order (but not actually decided) are included.

[63] *Id*., Table 3. In Table 3, the Company proposes the Commission take into consideration only the items related to distribution costs for Washington –disregarding impacts associated with inter-jurisdictional cost allocations, because distribution costs are treated as *situs* costs. PacifiCorp asserts this approach results in an increase in revenue requirement over the Company's last rate case of approximately $5.9 million.

[64] *Jewell,* 90 Wn.2d at 776-777; *see also Pacific Telephone*, 19 Wn.2d at 215.

[65] *POWER II*, 104 Wn.2d at 808.

[66] *Hope*, 320 U.S. at 602, 603; *Permian Basin Rate Cases*, 390 U.S. at 797; *see also Jersey Central,* 810 F.2d at 1176-77.

[67] *POWER II*, 104 Wn.2d at 811 (emphasis added).

52 PacifiCorp's petition for reconsideration asserts that the results of our Order fall outside of the "zone of reasonableness" and violate the "end results" test. The "end result" of our decision – that PacifiCorp's rates do not increase – is not unjust, unreasonable, or unconstitutional. Opposing parties presented evidence and arguments in support of little or no rate increase or a reduction from current rates. PacifiCorp relied entirely upon the Revised Protocol for its rate setting, which we rejected for the reasons discussed above. Where the Company failed to present the Commission with an alternative to the Revised Protocol for allocating costs to Washington State, the burden does not shift to the Commission to develop an alternative basis for determining the rate base or operating revenues upon which to establish new rates. Nor are we required to reopen the record to allow the Company a second chance at proving the efficacy of the Revised Protocol.

53 The Company relies on *Jersey Central* for the proposition that it is entitled to additional process – a *Hope* "end results" hearing — to determine whether we fairly considered the Company's financial condition.[68] The court in that case said:

> When the Commission conducts the requisite balancing of consumer and investor interests, based upon factual findings, that balancing will be judicially reviewable and will be affirmed if supported by substantial evidence. That is the point at which deference to agency expertise will be appropriate and necessary. But where, as here, the Commission has reached its determination by flatly refusing to consider a factor to which it is undeniably required to give some weight, its decision cannot stand. [Citation omitted] The case should therefore be remanded to the Commission for a hearing at which the Commission can determine whether the rate order it issued constituted a reasonable balancing of the interests the Supreme Court has designated as relevant to the setting of a just and reasonable rate.[69]

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[68] In footnote 3 of *Jersey Central*, the court states "where the sort of deep financial hardship described in *Hope* is present, the utility is entitled only to an "end result" hearing, and is not entitled to any greater return on its investments unless it shows at the hearing both that the rate was unreasonable and that a higher return would not exploit consumers." 810 F.2d at 1182, n.3.
[69] *Id*. at 1181-82.

54 Contrary to the facts in *Jersey Central*, we provided the Company ample opportunity to demonstrate that its allocation method was appropriate, that it was entitled to rate relief, and that it would suffer financial hardship without approval of the Revised Protocol. After receiving testimony and evidence from all parties, including an opportunity for the Company to respond to testimony by other parties, extensive hearings and an opportunity for briefing, we analyzed the issues and discussed our reasoning at length in the Order. The Company is not entitled to a second chance to present its case for rate relief through reconsideration once we have made our decision on the evidence. Reconsideration of a decision is not an opportunity to reopen the case.

55 While PacifiCorp invokes the *Hope* standard to argue financial hardship, the Company presented no evidence of financial hardship other than the claim it is achieving earnings of only 2.8 percent to 3.5 percent on equity.[70] Regardless of whether such earnings could be said to constitute financial hardship, these figures are unreliable. They are based on an allocation of assets to Washington using the Revised Protocol and its now abandoned predecessor, the Modified Accord. Neither allocation method is proved on this record to allocate assets fairly to Washington ratepayers in a manner consistent with Washington law.

56 Even if we assume the efficacy of the Revised Protocol, there is no evidence of record citing the Company's lack of access to capital markets or other indicia of financial hardship. What the record demonstrates is that the Company was acquired, along with its Washington revenues at current rates, by MidAmerican Energy Holding Company (MEHC) for an acquisition premium of 31 percent or $1.2 billion in the course of this rate proceeding.[71] Moreover, the Company received a rate increase as

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[70] Exh. 191T at 2:5-8 (Wrigley); Exh. 193 at page 1.0, line 60; page 9.0, line 60 (Wrigley).
[71] MEHC paid $5.1 billion for assets valued at book value of $3.9 billion. *See* Exh. 791T at 11:1-6 (Elgin). An outside acquirer placed a substantial premium over book value given PacifiCorp's current rates and operations.

recently as 2004.[72] These facts, coupled with the lack of a showing that the Company is facing financial hardship, do not demonstrate a violation of the "end results" test. In fact, in its rebuttal comments in Docket UE-060669 on the 2.99 percent filing, PacifiCorp asserts it is not seeking interim rate relief, which implies the Company does not face urgent financial distress.

57 Because we deny the Company's arguments that our decision violates the *Hope* "end results" test, we need not reach the merits of the company's theories upon which rate relief could be calculated. [73]

58 In summary, our Order set a fair rate of return for PacifiCorp based on the record before us. We are confident that the total effect of the Order cannot be said to be unjust or unreasonable. It is not unfair to require the Company to meet its burden of proof or for the Commission to abide by its statutory standards. Allowing the Company to continue to earn a return on the basis of rates set in 2004, where the Company has not met its burden to show these rates are insufficient is not unconstitutional.

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[72] *See WUTC v. PacifiCorp, d/b/a Pacific Power & Light Company*, Docket UE-032065, Order 06, Approving and Adopting Settlement Agreement Subject To Conditions; Rejecting Tariff Sheets; Authorizing and Requiring Compliance Filing (Oct. 27, 2004); *see also WUTC v. PacifiCorp, d/b/a Pacific Power & Light Company*, Docket UE-991832, 3rd Supplemental Order (Aug. 9, 2000).

[73] The Company's rate relief proposals have significant flaws. First, the Company relies on two approaches that significantly and inappropriately deviate from traditional rate making. Averaging the parties' proposed revenue adjustments, as stated by the Company, together with the Company's final request, is a clear departure from Commission practice to assess items in dispute individually and make specific decisions on those items.

Second, even if such an approach were acceptable, there are significant problems with the Company's analysis and conclusions. Each of the parties' proposals is based to some extent upon the Revised Protocol, an allocation method we have rejected. It is not appropriate to characterize Public Counsel's adjustments as comprehensive, as Public Counsel did not address every rate base or revenue requirements issue in the case. While the Order addressed the theories or policies for certain contested adjustments, the Order provides no basis for the parties to speculate about the actual revenue requirement resulting from that analysis.

B. PacifiCorp's Request for Rate Relief of 2.99 Percent

59 In addition to the request for rate relief in its petition for reconsideration, PacifiCorp also seeks rate relief through a separate filing in Docket UE-060669 seeking a rate increase of 2.99 percent, or $7 million. PacifiCorp asserts that the filing is necessary to allow some of its $11 million requested rate relief to go into effect while we address the petition for reconsideration and the courts address any subsequent appeals. The Company bases its request on the evidence in the rate case proceeding.

60 ***Discussion and Decision.*** As the Company's 2.99 percent request for rate relief is based on the same evidence as the request for rate relief in the petition for reconsideration, we find the 2.99 percent filing raises the same issues and suffers the same fate as the request in the petition. As we stated above, the evidentiary record supports our finding that the existing rates remain fair, just and reasonable, and does not support PacifiCorp's claim that rate relief is warranted. Therefore, we deny the Company's request in Docket UE-060669 as unnecessary and duplicative.

61 PacifiCorp argues that the 2.99 percent filing is intended to provide the Commission and the parties flexibility to allow time for discussion on a new allocation method before the Company files a new rate case. We believe the Company and the parties can and should engage in such discussions based on the record in this proceeding without further process.

62 Our rejection of the Revised Protocol does not present an insurmountable barrier to future rate relief. The Company stated in the record several times its intention to file a new general rate case soon after the disposal of this case. We encourage all parties to engage in good faith discussions towards developing an acceptable allocation method consistent with the guidelines we have provided.

Nor need we reach the due process issues Public Counsel raises in challenging the Company's attempt to recalculate rates at this stage of the proceeding.

C. Staff's Petition for Reconsideration

63 Staff seeks reconsideration of a narrow portion of the Order related to PacifiCorp's petition for approval of deferral accounting in Docket UE-050412. In that docket, PacifiCorp sought approval to establish a deferral account for costs relating to declining hydroelectric generation. The Company also sought to recover these costs in the rate case by allocating to Washington customers a portion of the deferred costs based on the Revised Protocol.[74]

64 We approved PacifiCorp's request to defer excess power costs due to declining hydroelectric generation, finding that low water conditions through most of 2005 were extraordinary.[75] We denied recovery of the deferred costs, however, finding the Company had not shown that the power costs were prudently incurred.[76] We also found it would be inappropriate, based on the evidence, to adopt Staff's proposal to apply a 15-percent dead band to the excess power costs deferred under the Company's petition.[77]

65 Staff objects to our apparent rejection of a proposed 15-percent dead band around deferral and future recovery of extraordinary hydroelectric costs. Staff contends we did not consider the theory or explanation it offered in its brief that its proposed 15-percent dead band in this case is intended to strike "an appropriate risk sharing balance [and] is unrelated to what water years are included in base rates."[78]

66 Staff requests that we reconsider our decision in paragraph 313 and decide either to "1) rule that Staff's 15 percent band does not constitute double counting, and that the

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[74] Exh. 398T at 3:1, 4:1-13, 20-22 (Widmer); *see also* PacifiCorp Initial Brief, ¶ 56 and TR 750:14-16 (Widmer).
[75] Order, ¶ 306.
[76] *Id.*, ¶¶ 310-312.
[77] *Id.*, ¶ 313.
[78] Staff Petition, ¶ 6, quoting Staff Opening Brief, ¶¶ 105-106.

band will be used to calculate recoverable deferred hydro costs; or 2) permit the issue of a band to be addressed again when and if PacifiCorp seeks recovery in rates of power costs approved for deferral in Docket UE-050412."[79]

67 The Company urges the Commission to reject Staff's petition.[80]

68 ***Discussion and Decision.*** We deny Staff's request to reconsider our decision in paragraph 313 of the Order, but clarify that we do not reject the concept of a dead band or other risk sharing proposal. Regardless of Staff's explanation in brief and in its petition, this record does not support applying such a dead band.

69 In the Order, we reserved for a later date the issue of the ultimate recovery in rates of any deferred amounts. We also reserved the issue of determining the precise calculation of deferral amounts until after an allocation method is established. We determined only that it is appropriate for some level of costs to be deferred (over a finite period of time) and did not specify any precise method of calculation. There is nothing in the Order that precludes Staff from arguing its risk sharing theory, whether 15 percent or some other proposal, at the time the Company seeks rate recovery.

FINDINGS OF FACT

70 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary of those facts, incorporating by reference pertinent portions of the preceding detailed findings:

71 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules,

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[79] *Id.*, ¶¶ 8, 12.
[80] PacifiCorp Petition, ¶ 7.

regulations, practices and accounts of public service companies, including electric companies.

72 (2) PacifiCorp is a "public service company" and an "electrical company" as those terms are defined in RCW 80.04.010, and as those terms otherwise may be used in Title 80 RCW. PacifiCorp is engaged in Washington State in the business of supplying utility services and commodities to the public for compensation.

73 (3) PacifiCorp provides retail electric service in six states: Utah, Oregon, Idaho, Wyoming, California and Washington.

74 (4) The Revised Protocol is PacifiCorp's proposed method or plan for allocating costs and wholesale revenues associated with the Company's generation, transmission and distribution system across its six-state service territory for the purpose of setting retail rates.

75 (5) Mr. Duvall and Mr. Taylor discussed in testimony the possible benefits to Washington of the merger between Pacific Power and Utah Power and of the Company's system, but did not quantify the benefits or provide sufficient support for the benefits to justify approval of the Revised Protocol.

76 (6) The South Idaho Exchange Contract, and Mr. MacRitchie's unsupported reference to a study of merger benefits not in the record, are not sufficient to justify including all Eastside resources in rate base, or to approve the Revised Protocol.

77 (7) Footnote 10 of the Order is corrected to reflect that the Wyoming coal plants are located in the Eastern, not the Western, control area.

78 (8) Paragraph 70 of the Order is clarified to reflect that the Company is expected to include the full value of hydroelectric resources attributable to the Western control area in any inter-jurisdictional cost allocation model it develops for Washington, understanding this does not mean that all of the value of such resources are attributable to the Western control area.

79 (9) PacifiCorp's claim that it is achieving earnings of 2.8 to 3.5 percent is based on an allocation of assets to Washington using the Revised Protocol and the Modified Accord methods of inter-jurisdictional cost allocation.

80 (10) The acquisition of the Company by MEHC during the course of this proceeding for a $1.2 billion acquisition premium and recent rate increases indicate that PacifiCorp does not face emergent financial hardship.

81 (11) The evidence in the record relating to Staff's proposed 15-percent dead band proposal does not support applying such a dead band.

CONCLUSIONS OF LAW

82 Having discussed above all matters material to this decision, and having stated detailed findings, conclusions, and the reasons therefore, the Commission now makes the following summary conclusions of law, incorporating by reference pertinent portions of the preceding detailed conclusions:

83 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, these proceedings.

84 (2) The Commission regulates in the public interest, ensuring that rates or charges for services rendered by a public utility are fair, just, reasonable and sufficient.

85 (3) When applying its rate making authority, the Commission must act within its statutory authority, within constitutional limitations, and in a lawful manner.

86 (4) In determining the fair value of public utility property for ratemaking purposes, i.e., establishing the appropriate rate base, the Commission must determine whether the property is "used and useful for service in this state." *See* RCW 80.04.250.

87 (5) RCW 80.04.250 requires that a public service company demonstrate that a resource provides benefits to ratepayers in Washington either directly (e.g., the flow of power from a resource to customers) and/or indirectly (e.g., reduction of costs to Washington customers through exchange contracts or other quantifiable tangible or intangible benefits), commensurate with its cost before the resource is included in rate base.

88 (6) Requiring a public service company to demonstrate a resource provides direct or indirect, tangible or intangible, benefits to Washington customers is consistent with RCW 80.04.010, and gives the term "'service' … "its broadest and most inclusive" meaning.

89 (7) A public utility company bears the burden of proof that any requested increase in rates or charges is fair, just and reasonable. *See* RCW 80.04.130.

90 (8) PacifiCorp did not meet its burden of proof to show that the Revised Protocol meets the used and useful requirement of RCW 80.04.250.

91 (9) Where a company fails to meet a statutory requirement to enable allocation of its costs to Washington customers, the denial of a rate increase is not unfair or unreasonable.

92 (10) While PacifiCorp was given ample due process and the opportunity to demonstrate financial hardship in this proceeding, the Company has not shown that it faces financial hardship under current rates.

93 (11) The Order is supported by substantial evidence and considers the *Hope* standard in setting a fair rate of return. The total effect of the Order cannot be said to be unjust or unreasonable. *See Hope*, 320 U.S. at 602.

94 (12) The finding in paragraph 56 of the Order that PacifiCorp assumed the risk in merging with Utah Power that divergent allocation decisions among the states in its service territory might result in under-recovery of costs is not material to the ultimate decision in the Order, and does not provide a basis for reconsidering the Order.

95 (13) The alleged errors or misstatements of fact in the Order are not material to the ultimate decision, and do not provide a basis for reconsidering the Order.

96 (14) PacifiCorp's request for a 2.99 percent rate rider surcharge in Docket UE-060669 is duplicative of its request in Docket UE-050684, and fails for the same reasons as the Company's request in its petition for reconsideration.

97 (15) Nothing in the Order precludes Staff from addressing its risk sharing theory in the future, if the Company seeks recovery in rates of deferred excess power costs.

98 (16) The Commission should retain jurisdiction over the subject matter and the parties to this proceeding to effectuate the terms of this Order.

ORDER

THE COMMISSION ORDERS:

99 (1) PacifiCorp d/b/a Pacific Power and Light Company's petition for reconsideration of the Commission's final order in consolidated Dockets UE-050684 and UE-050412 is denied.

100 (2) Commission Staff's petition for reconsideration of the Commission's final order in consolidated Dockets UE-050684 and UE-050412 is denied.

101 (3) PacifiCorp d/b/a Pacific Power and Light Company's application for a tariff revision in Docket UE-060669 requesting a 2.99 percent rate rider surcharge is rejected.

Dated at Olympia, Washington, and effective July 14, 2006.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner