

**BEFORE THE WASHINGTON  
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

PACIFIC POWER & LIGHT  
COMPANY, a Division of PacifiCorp,

Respondent.

DOCKET UE-152253

**PACIFIC POWER’S REPLY IN  
SUPPORT OF COMPLIANCE FILING**

**I. INTRODUCTION**

1           In accordance with the Notice of Opportunity to Comment on Pacific Power & Light Company’s (Pacific Power or Company) Compliance Filing, issued on September 14, 2016, by the Washington Utilities and Transportation Commission (Commission), Pacific Power submits the following reply to Commission Staff’s response regarding the Company’s compliance filing. As directed by the Notice, Staff’s response addressed two issues: (1) the Company’s treatment of debt interest on the selective catalytic reduction (SCR) systems and the associated tax treatment Pacific Power used in its calculation; and (2) the Company’s modification of the Idaho Power asset exchange classification from a pro forma adjustment to a restating adjustment.

**II. BACKGROUND**

2           On September 1, 2016, the Commission entered Order 12.<sup>1</sup> Paragraph 329 required the Company to submit its compliance tariffs “at least five full business days prior to their stated effective date, which shall be no sooner than September 15, 2016.”

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<sup>1</sup> *WUTC v. Pacific Power & Light Company*, Docket UE-152253, Order 12 (Sept. 1, 2016) (Order 12).

To ensure a rate effective date of September 15, 2016, the compliance filing was due on September 8, 2016.<sup>2</sup> On September 8, 2016, the Company sought an extension of two days, to September 12, 2016, for its compliance filing to allow the Company additional time to complete its reconciliation calculations and prepare revised tariffs, while maintaining the September 15, 2016, rate effective date. The Commission granted this motion on September 12, 2016.<sup>3</sup>

3           On September 9, 2016, the Commission issued Order 13, Supplemental Order Amending the Calculations in Order 12.<sup>4</sup> In Order 13, the Commission adjusted the authorized revenue requirement to include the tax impact of limiting recovery of the SCR systems to the “return of” the investment, with no “return on” the investment.<sup>5</sup> Order 13 authorized an amended revenue increase of \$5,395,338 for the first year of the rate plan, effective September 15, 2016, and \$7,607,991 for the second year, effective September 15, 2017.<sup>6</sup> Order 13 also included an adjustment summary of the Commission’s first-year revenue requirement model results in Appendix A.

4           To prepare its compliance filing, Pacific Power compared its revenue requirement calculations to Appendix A of Order 13, but the Company could not replicate the exact revenue requirement increase articulated in Order 13. The Company provided its models and supporting workpapers to Staff and conferred on the specific calculations used to model each adjustment. Staff agreed that the Company calculated the revenue requirement correctly, even though the revenue deficiency totals did not precisely match those stated in Order 13.

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<sup>2</sup> Order 12 ¶ 329.

<sup>3</sup> *WUTC v. Pacific Power & Light Company*, Docket UE-152253, Order 14 (Sept. 12, 2016).

<sup>4</sup> *WUTC v. Pacific Power & Light Company*, Docket UE-152253, Order 13 (Sept. 9, 2016) (Order 13).

<sup>5</sup> Order 13 ¶ 2.

<sup>6</sup> *Id.*

5           On September 12, 2016, the Company submitted its compliance filing requesting approval of a first-year revenue increase of \$5,624,706, and a second-year revenue increase of \$7,901,569. These amounts are \$229,368 and \$293,578 higher than specified in Order 13 for the first- and second-year revenue increases, respectively. The Company explained that the variances from Order 13 were primarily attributable to three adjustments, as outlined in Attachment A to the compliance filing, an adjustment-by-adjustment comparison to Appendix A of Order 13.<sup>7</sup>

6           First, the Company's model reflects corrections to the Idaho Power asset exchange adjustment to more comprehensively capture the impacts of the Commission's decision to exclude exchange assets and reassignment assets associated with the Idaho Power transaction.<sup>8</sup> The Company's calculations resulted in a revenue requirement reduction that is \$11,531 larger than the amount identified in Order 13, Appendix A.<sup>9</sup>

7           Second, the Company's compliance filing reflects a variance in the PowerTax accumulated deferred income tax balance adjustment to accurately update deferred tax balances based on Orders 12 and 13. Specifically, the Company modified this adjustment to correctly capture deferred tax balances that result from excluding the SCR systems and Idaho Power asset exchange assets from rate base, and from using end-of period rate base balances.<sup>10</sup> This adjustment resulted in a revenue requirement reduction that is \$52,520 larger than the amount identified in Order 13, Appendix A.<sup>11</sup>

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<sup>7</sup> Together, the three variances identified between the Company's first-year revenue increase in the compliance filing and Order 13, Appendix A total \$228,204. The Company has not identified the cause of the remaining variance of \$1,164, although it is likely attributable to rounding.

<sup>8</sup> Order 12 ¶¶ 216-17.

<sup>9</sup> See column K, line 57 of Attachment A to the compliance filing.

<sup>10</sup> Order 12 ¶¶ 116, 216-17, 173.

<sup>11</sup> This variance is shown in column K, line 37 of Attachment A to the compliance filing.

8 Third, the Company's compliance filing included a revised calculation of the interest true-up adjustment. This calculation produced a revenue requirement variance that is \$292,255 higher than the amount identified in Order 13, Appendix A.<sup>12</sup> The Company followed its standard approach to calculating the interest expense eligible as a deduction for income tax purposes, multiplying the Company's total rate base by the Company's authorized weighted cost of debt. Because the Commission excluded the SCR systems from rate base in Order 12,<sup>13</sup> the Company did not reflect the costs of debt financing or the interest deduction on the SCR systems in its calculations.

### III. DISCUSSION

#### A. Treatment of Debt Interest on the SCR Systems.

9 The Company appreciates the observation in Staff's response that if the Company's compliance filing accurately reflects the intent of the Commission's decision, a revenue requirement discrepancy does not render the filing non-compliant.<sup>14</sup> The Company's compliance filing accurately reflects the tax consequences of the Commission's decision on the SCR systems, even though it does not tie exactly to Order 13, Appendix A.

10 The Company captures the cost of debt financing by multiplying rate base by the overall weighted average cost of debt and then dividing that product by the net-to-gross factor. This calculation results in the revenues necessary to cover the cost of debt service. In addition, the Company's interest expense is tax deductible, meaning that debt financing provides a customer benefit through a reduction in the income tax calculation. The interest true-up adjustment captures this income tax benefit. Combined, the revenues

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<sup>12</sup> This variance is shown in Column K, line 34 of Attachment A to the compliance filing.

<sup>13</sup> Order 12 ¶ 116.

<sup>14</sup> Staff Response to Compliance Filing at 2.

collected from customers to cover the cost of debt financing, less the benefit provided by the tax deductibility of the interest expense, result in the net revenue requirement for debt financing.

Based on the Commission's request for comment on the treatment of debt interest on the SCR systems, the Company surmises that the Commission's calculations in Order 13, Appendix A may reflect an interest expense tax deduction (*i.e.*, a revenue requirement benefit) associated with the SCR systems, without reflecting the interest expense. Including the interest expense tax deduction without the interest expense, however, would be contrary to the Commission's decision in Order 12 allowing a "return of" the Company's investment in the SCR systems. In other words, this treatment would result in the Company recovering an amount *less* than the "return of" the investment. Specifically, in the first year of the rate plan, the Company would collect \$1,660,082 for the SCR systems, compared to revenue requirement associated with the depreciation expense of \$1,950,040.<sup>15</sup>

11 In Order 12, the Commission described its "long-standing principle of benefits following burden[s]." <sup>16</sup> The Commission has also consistently adhered to the matching principle in setting rates.<sup>17</sup> These principles require either the exclusion of the interest

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<sup>15</sup> The revenue requirement associated with the depreciation expense (\$1,950,040) is shown in column E, line 47 in Order 13, Appendix A. This amount less the revenue requirement impact of the interest expense income tax deduction (\$289,957) would result in recovery of \$1,660,082.

<sup>16</sup> Order 12 ¶ 216. *See also* *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 ¶ 285 (Apr. 17, 2006).

<sup>17</sup> *WUTC v. Puget Sound Energy*, Docket UE-090704 et al., Order 11 ¶ 27 (Apr. 2, 2010) ("The matching principle requires that all factors affecting a proposed pro forma change be considered in determining the pro forma level of expense. . . . If offsetting factors are not taken into account, the known and measurable change will result in overstated or understated revenue requirements. That is, a mismatch in the relationship of revenues, expenses, and rate base is created.").

expense tax deduction on the SCR systems (as reflected in the Company's compliance filing) or the inclusion of the cost of debt financing on the SCR systems.<sup>18</sup>

12           Income tax normalization rules also require consistent rate treatment of interest expense and the associated tax benefits. Internal Revenue Code section 168(i)(9) specifically forbids the use of inconsistent estimates, projections, assumptions, and the like, in the calculation of and the application of tax expense, depreciation expense, and the deferred tax reserve for ratemaking purposes.<sup>19</sup>

**B.     Classification of Idaho Power Asset Exchange.**

13           The Company's compliance models label the Idaho Power asset exchange adjustment as "restating" rather than "pro forma" because the Commission-ordered treatment requires the Company to remove assets recorded in the per books (historical) data. The Company's labeling convention reflects the Commission's limited approval to include in revenue requirement only those assets already in rates, and has no revenue requirement impact.<sup>20</sup> Staff supports the Company's approach.<sup>21</sup>

**IV.    CONCLUSION**

14           Staff supports the Company's compliance filing and no other party responded to the Commission's Notice. In Order 12, the Commission provided a compliance process that contemplated an effective date for new rates of September 15, 2016, to which the

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<sup>18</sup> Including the cost of debt financing would result in a revenue deficiency that is approximately \$828,000 greater than the amount reflected in Order 13, or approximately \$538,000 greater than the Company's compliance filing.

<sup>19</sup> 26 U.S.C. § 168(i)(9)(B)(ii) ("The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.").

<sup>20</sup> Order 12 ¶¶ 216-17.

<sup>21</sup> Staff Response to Compliance Filing at 2.

Company diligently responded.<sup>22</sup> The one-week delay in the rate effective date of Orders 12 and 13 equates to approximately \$100,000 of lost revenues to the Company. For this reason, and for the reasons outlined above, the Company respectfully requests that the Commission review and approve the Company's compliance filing on an expedited basis.

Respectfully submitted this 22nd day of September, 2016.



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<sup>22</sup> On September 12, 2016, the Company filed a Motion for Clarification on two issues addressed in Order 12. To avoid delay of the September 15, 2016, rate effective date for all other components of Order 12 and 13, the Company filed compliance tariffs that excluded the issues addressed in the Motion for Clarification. Therefore, the pendency of the Motion for Clarification should not delay approval of the compliance filing.