

Exhibit No. ___ CT (KHB-1CT)
Docket UE-111190
Witness: Kathryn H. Breda
REDACTED VERSION

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

**PACIFICORP D/B/A PACIFIC POWER
& LIGHT COMPANY,**

Respondent.

DOCKET UE-111190

TESTIMONY OF

Kathryn H. Breda

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

*Renewable Energy Credits, Pension Curtailment Gain, Liability Suits and Property
Damage, Regulatory Commission Expense, Interest True-Up, Deferred Chehalis
Maintenance*

January 6, 2012

CONFIDENTIAL PER PROTECTIVE ORDER – REDACTED VERSION

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LIST OF EXHIBITS

Exhibit No. ___ (KHB-2C)	Adjustment 3.5, Renewable Energy Credit (REC) Revenue
Exhibit No. ___ (KHB-3)	Adjustment 4.6, Pension Curtailment Gain
Exhibit No. ___ (KHB-4C)	Adjustment 4.11, Liability Suits, and Property Damage
Exhibit No. ___ (KHB-5C)	Adjustment 4.14, Regulatory Commission Expense
Exhibit No. ___ (KHB-6)	Adjustment 7.1, Interest True Up
Exhibit No. ___ (KHB-7)	Adjustment 8.6, Miscellaneous Rate Base

1 I. INTRODUCTION

2
3 Q. Please state your name and business address.

4 A. My name is Kathryn H. Breda. My business address is The Richard Hemstad
5 Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA
6 98504. My email address is kbreda@utc.wa.gov.

7
8 Q. By whom are you employed and in what capacity?

9 A. I am employed by the Washington Utilities and Transportation Commission
10 (“Commission”) as a Regulatory Analyst.

11
12 Q. How long have you been employed by the Commission?

13 A. I have been employed by the Commission since 2008.

14
15 Q. Would you please state your educational and professional background?

16 A. I graduated from the University of Washington in 1980 receiving a Bachelor of Arts
17 in Business Administration with a major in Accounting. I am a licensed Certified
18 Public Accountant in the State of Washington.

19 My responsibilities at the Commission generally comprise financial,
20 accounting and other analyses in general rate cases, accounting petitions, other tariff
21 filings, and compliance filings. I testified in Docket UE-090704 and UE-100749,
22 and participated in Staff’s review of Dockets UE-100467/UG-100468, UE-
23 090134/UG-090134, UE-090205, UE-080220 and UG-080546.

1 Prior to my employment with the Commission, I held various corporate
2 accounting and regulatory management positions from 1980 through 2000 with
3 Qwest Communication in Seattle and Pacific Gas and Electric Company in San
4 Francisco.

5
6 **II. SCOPE AND SUMMARY OF TESTIMONY**

7
8 **Q. What is purpose of your testimony?**

9 A. The purpose of my testimony is to present Staff's position and recommendation on
10 the following adjustments and their related ratemaking issues:

- 11 1. Adjustment 3.5, Renewable Energy Credit (REC) Revenue
- 12 2. Adjustment 4.6, Pension Curtailment Gain
- 13 3. Adjustment 4.11, Liability Suits and Property Damage
- 14 4. Staff Adjustment 4.14, Regulatory Commission Expense
- 15 5. Adjustment 7.1, Interest True-Up
- 16 6. Adjustment 8.6, Miscellaneous Rate Base

17
18 **Q. Please summarize your recommendations.**

19 A. Based on my analysis, I recommend the Commission:

- 20 1. If the Commission decides in Docket UE-100749 that PacifiCorp's 2010
21 REC Revenues should be addressed in this docket, then Staff recommends
22 the Commission return \$9,563,356¹ of PacifiCorp's Washington 2010 REC

¹ Breda Exhibit No. (KHB-2C), 2010 REC Revenues provides this calculation.

1 revenues to ratepayers in this docket, via a tariff credit.

2 2. Accept Staff's Adjustment 4.6, Pension Curtailment Gain, which properly
3 includes the unamortized regulatory liability, net of accumulated deferred
4 income taxes, as a reduction to the rate base, in addition to the amortization
5 of the gain in operating results. This adjustment reduces net rate base by
6 \$2,644,739 for an overall decrease of \$330,040 in revenue requirement.
7 These are Washington figures. My Exhibit No. (KHB-3) contains the
8 calculation of these figures.

9 3. Accept Staff's Adjustment 4.11, Liability Suits and Property Damage,
10 thereby rejecting the Company's "self-insurance", and accepting Staff's
11 proposal to include a normalized level of expenses related to property
12 damage and liability suits. This adjustment increases net operating income
13 by \$77,717 for an overall decrease in revenue requirement of \$125,304.
14 These are Washington figures. My Exhibit No. (KHB-4C) contains the
15 calculation of these figures.

16 4. Accept Staff's Adjustment 4.14, Regulatory Commission Expense, which
17 adjusts the results of operations to reflect a normalized level of Account 928
18 Regulatory Commission Expense. This adjustment increases net operating
19 income by \$249,489 for an overall decrease in revenue requirement of
20 \$474,806. These are Washington figures. My Exhibit No. (KHB-5C)
21 contains the calculation of these figures.

22 5. Accept Staff's Adjustment 7.1, Interest True-up, which synchronizes the
23 interest expense used to compute income tax with the interest provided

1 through the cost of capital return computation. Staff's adjustment merely
2 updates this adjustment for the changes made by staff to the overall rate base.
3 This adjustment decreases net operating income by \$405,903 for an overall
4 increase in revenue requirement of \$654,439. These are Washington figures.
5 My Exhibit No. (KHB-6) contains the calculation of these figures.

6 6. Accept Staff's Adjustment 8.6, Miscellaneous Rate Base, which in addition
7 to the Company's adjustment removes Chehalis deferred maintenance from
8 the rate base. The deferral of maintenance expenses at the Chehalis plant has
9 not been authorized by the Commission. This adjustment decreases net
10 operating income by \$71,785 and reduces net rate base by \$21,439,738 for an
11 overall decrease of \$2,559,778 in revenue requirement. These are
12 Washington figures. My Exhibit No. (KHB-7) contains the calculation of
13 these figures.

14 III. ADJUSTMENT 3.5, REC REVENUE

15
16
17 **Q. Please provide a summary of the pending regulatory treatment of REC revenue**
18 **in Docket UE-100749.**

19 A. In Order 06 of Docket UE-100749, the Commission determined that the proceeds
20 derived from PacifiCorp's sale of REC revenues should be returned to customers "in
21 the form of bill credits, identified separately on customers' bills."² However, two
22 issues still remain before the Commission in that docket: (1) the appropriate start

² *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-100749, Order 06, at 71, ¶ 202 (March 25, 2011).

1 date, or years to include in the tariff, and (2) the calculation of the REC revenues to
2 be returned to customers.

3

4 **Q. Please summarize Staff's recommendation for REC Revenue in Docket UE-**
5 **100749.**

6 A. Staff's recommendation in that docket was for the Commission to use January 1,
7 2009, the beginning of the test year in Docket UE-100749, as the start date for
8 returning REC revenues to ratepayers, and to use Staff's calculation of the REC
9 revenue amount.

10

11 **Q. Please summarize PacifiCorp's Adjustment 3.5, REC Revenue, in this case.**

12 A. PacifiCorp's Adjustment 3.5 "removes all REC revenue from the test period".³ The
13 Company removed \$8,233,862 of REC revenue.

14

15 **Q. How does the Company's calculation of 2010 REC revenues compare to Staff's**
16 **calculation?**

17 A. While Staff and Company calculate the same amount of REC revenues booked in
18 2010, Staff imputes additional REC revenue to account for Washington's share of
19 marketable RECs PacifiCorp held for compliance in other states, and did not make
20 available for sale. This is appropriate because Washington ratepayers pay a full
21 share of the costs of the assets used to generate the RECs, and the Company should
22 have sold Washington's share of these RECs for Washington's benefit rather than

³ Dalley Exhibit No. (RBD-1T) at 11:4-5.

1 hold them for the benefit of other states. Staff's imputation calculation uses
2 PacifiCorp's actual percentage of RECs sold at the average price of RECs sold.⁴

3
4 **Q. Please summarize Staff's recommendation for REC revenue in this case.**

5 A. If the Commission addresses the disposition of 2010 REC revenues in Docket UE-
6 100749, the Commission should accept the Company's adjustment to remove those
7 revenues in this docket. If the Commission decides in Docket UE-100749 that
8 PacifiCorp's 2010 REC revenue should be addressed in this docket, then Staff
9 recommends the Commission return \$9,563,356⁵ of PacifiCorp's Washington 2010
10 REC revenue to ratepayers in this docket, via a tariff credit.

11
12 **IV. ADJUSTMENT 4.6, PENSION CURTAILMENT GAIN**

13
14 **A. Background**

15
16 **Q. Please discuss how this regulatory liability was established.**

17 A. This regulatory liability was approved in Docket UE-090205, Order 09, authorizing
18 \$2,901,000 "recorded as a reduction in the existing pension regulatory asset and
19 amortized over three years."⁶ The amortization began January 1, 2010, when rates

⁴ Breda Exhibit No. (KHB-2C) provides the detailed calculation. This exhibit provides the calculation used by Staff in Docket UE-100749, Exhibit No. (KHB-8C).

⁵ Exhibit No. (KHB-2C), 2010 REC Revenues.

⁶ *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-090205, Order 09, at 20, footnote 86 (December 16, 2009).

1 went into effect for Docket UE-090205.⁷

2

3 **Q. Please describe Washington regulatory practice for the recognition of**
4 **regulatory liabilities.**

5 A. When the Commission authorizes a regulatory liability, it establishes a liability,
6 recognized in the rate base for regulatory purposes. It authorizes the deferral, in this
7 case, a gain, along with any related federal income tax.⁸ Next, the Commission
8 determines how and when the liability will be recognized in the results of
9 operations.⁹ In this instance, the Commission approved an all-party stipulation
10 providing for a three-year amortization.¹⁰

11

12 **B. PacifiCorp's Adjustment**

13

14 **Q. Please describe PacifiCorp's Adjustment 4.6, Pension Curtailment Gain.**

15 A. PacifiCorp states that its adjustment "removes the actual amortization in the historic
16 base period and replaces it with the pro forma amortization for the twelve months
17 period ending December 31, 2011."¹¹ This adjustment is summarized on Exhibit No.
18 (RBD-3) at 4.6.

⁷ Id. at 28 ¶ 86.

⁸ The Commission confirmed in *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE- 100749, Order 06, at 96, ¶ 281 (March 25, 2011), that the Chehalis Regulatory Asset should reflect associated deferred tax. This regulatory practice is consistent with all regulatory assets and liabilities.

⁹ The Commission has discretion to determine the most appropriate method based on the circumstances which could include a separate tariff, netting against other costs or other methods, in addition to an amortization over a specific time period.

¹⁰ *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-090205, Order 09, at 11, ¶ 29 (December 16, 2009).

¹¹ Dalley Exhibit No. (RBD-1T) at 14:10-12.

1 **C. Staff's Proposed Adjustment, Conclusion, and Recommendation**

2
3 **Q. Please describe Staff Adjustment 4.6, Pension Curtailment Gain.**

4 A. This adjustment restates the test period actual results of operations to reflect the
5 appropriate test period amortization and related tax expense in the results of
6 operations. In addition, the rate base is adjusted to reflect the average of the monthly
7 average (AMA) remaining regulatory liability net of accumulated deferred taxes.
8 Exhibit No. (KHB-3) Adjustment 4.6, Pension Curtailment Gain details this
9 adjustment.¹²

10
11 **Q. Please describe how Staff's adjustment differs from PacifiCorp's adjustment.**

12 A. There are two distinct differences between the PacifiCorp and Staff Adjustment: (1)
13 Staff's adjustment recognizes the remaining regulatory liability authorized by the
14 Commission, and (2) Staff's adjustment is based on the test year 2010, not the year
15 ending December 31, 2011.

16
17 **Q. Please explain why there should be recognition of the regulatory liability.**

18 A. A regulatory liability represents the deferral of a financial gain, or revenues that
19 would be realized in the period incurred, if not for the regulator's promise to
20 recognize the gain or revenues in rates over future time periods. In effect, the
21 regulatory liability represents a debt to be repaid to customers over a set amortization
22 period. The unamortized regulatory liability must also be recognized as a reduction

¹² Breda Exhibit No. (KHB-3).

1 to rate base net of accumulated deferred income tax. This reduction to the rate base
2 is consistent with standard regulatory practice. The opposite situation occurs for
3 regulatory assets; an expense is deferred and recovered over future periods with the
4 unamortized net balance recognized as an increase to rate base.¹³

5
6 **Q. Please explain why Staff's use of the test year amortization and balances is**
7 **appropriate.**

8 A. Typically, the test year amount of a regulatory asset or liability would be considered
9 in the test period. The Commission has at times allowed regulatory assets or
10 liabilities related to generation to be considered on a forward-looking basis.¹⁴ The
11 pension curtailment gain, however, is not related to generation; therefore, a future
12 period adjustment is not consistent with regulatory practice for this adjustment.

13
14 **Q. Please summarize your conclusion and recommendation.**

15 A. I recommend the Commission accept Staff's adjustment as consistent with the
16 regulatory practices of recognizing regulatory liabilities, net of deferred income
17 taxes, as a reduction to the rate base based on test period results. This adjustment
18 reduces the Washington rate base by \$2,644,739 and decreases the revenue
19 requirement by \$330,040.

20

¹³ An example of a PacifiCorp regulatory asset is the Chehalis Regulatory Asset included in Adjustment 8.8, Exhibit No. (RBD-3) at 8.8.

¹⁴ *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-100749, Order 09, at 11 ¶ 13 (March 25, 2011).

1 **V. ADJUSTMENT 4.11, LIABILITY SUITS AND PROPERTY DAMAGE**

2

3 **A. Background**

4

5 **Q. Please describe the captive insurance requirement of Docket UE-051090**
6 **approving the MEHC acquisition.**

7 A. As a condition of the settlement approved in Docket UE-051090, PacifiCorp agreed
8 to Commitment 5 to provide insurance coverage for PacifiCorp operations through
9 captive insurance “comparable in costs and services to that previously provided
10 through ScottishPower’s captive insurance company Dornoch.”¹⁵ The coverage
11 could not exceed \$7.4 million on a total Company basis and the commitment expired
12 December 31, 2010.

13

14 **Q. Is captive insurance a form of self-insurance?**

15 A. Yes. Captive insurance is provided by an affiliate who insures members of the
16 affiliated group.

17

18 **Q. What is PacifiCorp’s justification for discontinuing their captive insurance for**
19 **property damage and liability suits?**

¹⁵ *Wash. Utils. & Transp. Comm’n v. PacifiCorp*, Docket UE-051090, Order 07, Appendix A, pp. 14-15 (February 22, 2006).

1 A. PacifiCorp states that the commitment expired on December 31, 2010¹⁶ and they are
2 replacing it with self-insurance.¹⁷ The Company does not provide any further
3 justification for this change in testimony.
4

5 **Q. Does the Company have other property and liability insurance?**

6 A. Yes. Mr. Dalley states PacifiCorp has commercial insurance covering liability at
7 \$175.0 million per occurrence after a deductible of \$1.0 million, and insurance for
8 property damage, not related to transmission and distribution, covering \$400 million
9 per occurrence after a deductible of \$7.5 million.¹⁸
10

11 **Q. Is commercial insurance available for transmission and distribution property
12 damage?**

13 A. No. As provided by the Company in response to Public Counsel Data Request No.
14 244(b)¹⁹, commercial insurance has not been available at reasonable terms for
15 transmission and distribution grid systems since 2002.
16

17 **Q. Please define self-insurance.**

18 A. Self-insurance is defined as insurance of oneself or of one's own interests by the
19 setting aside of money at regular intervals to provide a fund to cover possible
20 losses.²⁰
21

¹⁶ Dalley Exhibit No. (RBD-1T) at 17:4.

¹⁷ Dalley Exhibit No. (RBD-1T) at 16:4-8.

¹⁸ Dalley Exhibit No. (RBD-1T) at 17:10-11 and 17:22 to 18:1.

¹⁹ Breda Exhibit No. (KHB-4C) at 11.

²⁰ Merriam-Webster Dictionary, <http://www.merriam-webster.com/dictionary/self-insurance>.

1 **Q. Is PacifiCorp setting aside money to fund its proposed self-insurance?**

2 A. No. The Company does not indicate that they are funding a reserve.

3

4 **Q. What is unfunded self-insurance?**

5 A. In the case of unfunded self-insurance, a company creates a “paper” or accounting
6 reserve. Funds are not specifically segregated to match the reserves accrued. An
7 unfunded reserve is basically “pay-as-you-go” insurance.

8

9 **B. PacifiCorp’s Insurance Proposal, Adjustment 4.11**

10

11 **Q. Please outline how the Company has presented their Insurance Proposal.**

12 A. PacifiCorp testifies that it is replacing its captive insurance with “self-insurance” for
13 “third-party liability, transmission and distribution (T&D) property and non-T&D
14 property.”²¹ The Company proposes to replace “the expense for captive insurance
15 premiums with an accrual to self-insurance reserves” that will “cover O&M related
16 damages.”²² In addition, PacifiCorp proposes different deductible limits for property
17 damage coverage under their “self-insurance”.²³

18

19 **Q. Is the Company’s proposal self-insurance?**

20 A. No. PacifiCorp is ceasing to have captive self-insurance and will not have any
21 insurance to replace it. Moreover, PacifiCorp does not discuss in testimony any

²¹ Dalley Exhibit No. (RBD-1T) at 16:6-8. PacifiCorp describes third-party liability coverage. In this document I describe this as “liability legal proceedings and settlements,” or “liability suits.”

²² Id. at 18:12-14.

²³ Id. at 18:16-21.

1 funding requirements with its proposal. Therefore, PacifiCorp's proposal does not
2 meet the requirements of a genuine funded self-insurance plan.

3
4 **Q. Please explain the Company's proposal.**

5 A. PacifiCorp is requesting to accrue, in advance, expenses for property damage and for
6 liability legal proceedings and settlements. Therefore, it is requesting to establish a
7 regulatory liability to use for future property damage and liability suits.

8 The Company states that its proposal "replaces the expense for captive
9 insurance premiums with an accrual to self-insurance reserves"²⁴ and "reflects
10 insurance expense on a pro forma basis for the 12-months ending December 31,
11 2011."²⁵ To accomplish this, the Company has included "approximately three
12 months of captive insurance premiums and "self insurance accruals for
13 approximately nine months."²⁶

14 To explain PacifiCorp's proposal, I look first to its adjustment for liability
15 suits.²⁷ PacifiCorp removes the Washington captive insurance premiums for liability
16 of \$114,185. This is the test year amount included in Account 925 Accidents and
17 Damages. To reflect its pro forma adjustment for the year 2011, the Company adds
18 back the captive insurance premium from January 1, 2011 to March 21, 2011,²⁸ or

²⁴ Id. at 18:11-15. PacifiCorp proposes to accrue to "self-insurance reserves." If authorized by the Commission these "reserves" would be regulatory liabilities; however, PacifiCorp has not recognized the liability or reduction to rate base in its proposal.

²⁵ Dalley Exhibit No. (RBD-1T) at 18:5-6.

²⁶ Id at 18:7-8.

²⁷ Liability suits are also described as liability, third-party liability or liability proceedings and settlements.

²⁸ Dalley Exhibit No. (RBD-3) at 4.11.1. PacifiCorp applies 21.92% to the total liability portion of the Captive Premium to represent a total Company amount of \$347,385. Exhibit No. (RBD-3) at 4.11 takes the total Company amount and applies the system overhead factor of 7.204% to calculation the Washington Amount included in the test period or \$25,027. Note that PacifiCorp has stated that it will no longer maintain captive

1 \$25,027, on a Washington basis. In addition, PacifiCorp includes an accrued amount
2 for liability “self-insurance” based on a three-year average of \$35,490 for
3 Washington.

4 For property damage, PacifiCorp removes the Washington captive insurance
5 premiums of \$400,599.²⁹ The Company *also* removes the Washington damage
6 accruals less any reimbursement from MEHC for captive insurance of \$622,787.³⁰

7 To determine its pro forma adjustment for property damage, PacifiCorp has
8 included a change to deductible levels. For property damage, the Company proposes
9 to increase the transmission and distribution deductible from \$25,000, as provided
10 with the prior captive insurance, to \$250,000 when the Company implements its
11 “self-insurance”.³¹ In addition, for non-transmission and distribution property, the
12 Company proposes to decrease the deductible of \$1.5 million under captive
13 insurance to \$1.0 million under “self-insurance.”³² The impact of this proposed
14 change by the Company increases Washington test period expense by \$475,548.³³

15 After considering its proposed changes in deductible limits for property
16 damage, the Company also includes approximately three months of captive insurance
17 premiums and damage accruals less reimbursements from MEHC for an increase to

insurance, and thus, this portion of its adjustment does not meet the requirements of a Pro Forma Adjustment as defined by WAC 480-07-510 (3)(e)(ii) and (iii). This is a known and measurable change, and therefore, all captive insurance should be removed from the test period.

²⁹ Dalley Exhibit No. (RBD-3) at 4.11.

³⁰ This is an appropriate adjustment to remove all effects of the prior captive insurance. However, for the liability portion of their adjustment, Pacific fails to remove the accruals less reimbursements for their prior captive insurance.

³¹ Dalley Exhibit No. (RBD-1T) at 18:18-20.

³² *Id* at 18:20-21.

³³ Dalley Exhibit No. (RBD-3) at 4.11.3 provides the deductible calculation. Exhibit No. (RBD-3) at 4.11 summarizes the Washington increase in section “Transfer to Exp due to change in deductible;” Account 571 - WCA Transmission Maintenance expense increases \$125,356; Account 593 - Washington Distribution Maintenance expense increases \$285,502; and Account 553 - WCA Non-Transmission and Distribution Maintenance expense increases \$64,690, for a total Washington increase of \$475,548.

1 Washington expense of \$224,303³⁴ through March 21, 2011, the date the captive
2 insurance expired.

3 For the remaining months of 2011, PacifiCorp proposes an expense level
4 based on the average experience of property damage claims based on the last 3.75
5 years.³⁵ This increases Washington expense by \$557,142.

6
7 **Q. Please discuss the tax impact of the captive insurance.**

8 A. The captive insurance premium expense, net of reimbursements received from
9 MEHC is not recognized for tax purposes.³⁶ In other words, the ratepayer has not
10 received the tax benefit of the captive insurance premium expense less any
11 reimbursement for the last five years. Because of the timing of reimbursements³⁷
12 included in the test year, the effect of removing these permanent tax differences
13 creates a revenue requirement of \$384,289³⁸ on a Washington basis.

14
15 **Q. What is the revenue requirement impact of PacifiCorp's adjustment?**

16 A. PacifiCorp's Adjustment 4.11 Self-Insurance decreases operating income by
17 \$317,266 and increases the revenue requirement by \$511,530.

³⁴ Id. at 4.11.2 and 4.11. Note: PacifiCorp has stated that it will no longer maintain captive insurance. To meet the requirements of a Pro Forma Adjustment as defined by WAC 480-07-510 (3)(e)(ii) and (iii), all captive insurance should be excluded. This is known as a measurable change, therefore, all captive insurance should be removed from the test period.

³⁵ Dalley Exhibit No. (RBD-1T) at 19:12-16.

³⁶ Breda, Exhibit No. (KHB-4C) at 14 provides response to WUTC data request number 107 that details the tax recognition.

³⁷ Reimbursement in 2010 was over \$16 million and the associated expense was incurred in prior years. Reimbursement detail is provided in response to Public Counsel Data Request 148, as set forth in Exhibit No. (KHB-4C) Adjustment 4.11, at 15 to 17.

³⁸ See Breda Exhibit No. (KHB-4C) at 5, for the calculation of the revenue requirement due to the permanent tax differences only.

1 **C. Staff's Proposed Adjustment, Conclusion and Recommendation**
2
3

4 **Q. Please summary Staff's proposal for liability and property damage.**

5 A. Staff's adjustment removes all captive insurance from the test year and reflects a six-
6 year average of actual claim activity, or in other words, a normalized level of
7 expense. Without any insurance, it is appropriate to consider a normalized level of
8 expense in the test period for liability suits and property damage. This allows for the
9 recognition of a representative level of costs that the Company will incur for
10 property damage and liability proceedings or settlements.

11
12 **Q. Please explain the liability portion of Staff's adjustment.**

13 A. Staff's Adjustment 4.11 has two distinct components - liability suits and property
14 damage. The portion related to liability suits removes the Washington captive
15 insurance premium of \$114,185, consistent with PacifiCorp's adjustment. In
16 addition, Staff's adjustment removed the Washington test year accruals less
17 reimbursements for claims of \$275,328.³⁹ After removing the test year expense
18 related to captive insurance, a Washington six-year average of claim activity or
19 expense of \$123,992⁴⁰ is included in the test period.

³⁹ Breda Exhibit No. (KHB-4C) at 3:3-6, and summarized on page 2:3. Note that PacifiCorp does not remove the accruals less reimbursements for the liability side of its adjustment although it makes the proper adjustment for property damage. Exhibit No. (KHB-4C) at 2:15.

⁴⁰ Breda Exhibit No. (KHB-4C) at 3:12-21.

1 **Q. Please explain the property damage portion of Staff's adjustment.**

2 A. The portion related to property damages removes the Washington test period captive
3 insurance premium of \$400,599 and the accrual less captive insurance
4 reimbursements of \$622,787.⁴¹ This is consistent with PacifiCorp's adjustment.

5 To recognize a normalized level of expense in lieu of captive insurance,
6 Staff's adjustment recognizes a six-year average of actual claims for Washington
7 distribution damages and Washington's portion of western control area (WCA)
8 transmission damages. For non-transmission and distribution property damage,
9 Staff's adjustment removes an extraordinary claim of [REDACTED] to provide a
10 normalized level of expense, based on a six-year average. The total adjustment to
11 expense on a Washington basis is \$802,654.⁴²

12
13 **Q. Please explain why Staff's adjustment removes an extraordinary claim from
14 non-transmission and distribution property damage.**

15 A. PacifiCorp experienced an extraordinary claim of [REDACTED] in connection with the
16 [REDACTED]. Based on the extraordinary⁴³ nature of
17 the event it has been removed before normalizing actual results.

⁴¹ Id at 4:1-6.

⁴² Id at 4:10-41.

⁴³ This is consistent with WAC 480-07-510 (3)(e)(ii), Restating actual adjustments in general rate proceedings and WAC 480-100-257, Commission basis reports.

1 **Q. Does PacifiCorp have an ability to recover extraordinary costs?**

2 A. Yes. The Company can always request the consideration of extraordinary prudently
3 incurred costs through an accounting petition. In this instance, the Company
4 recovered much of the damages through the captive insurance company and the
5 balance was included in expenses in prior rate cases.

6
7 **Q. Please explain why Staff's proposal for liability suits and property damage is
8 preferable to PacifiCorp's.**

9 A. By establishing an appropriate level of expense, instead of creating a reserve for
10 damage claims, actual events or occurrences of liability suits and property damages
11 are available for audit or review during a proceeding.

12 An audit or review is necessary to determine whether each cost or expense is
13 appropriate. When considering property damage and liability suits, a primary
14 question is whether the cost is unusual or extraordinary and not representative of a
15 normal level of expense. Other audit or review questions may look at the
16 Company's management decisions and whether the event or cost could have been
17 prevented or mitigated. Overall, by recognizing actual costs or expense in operating
18 results, the audit or review process is enhanced. This approach allows for the review
19 of actual costs.

20 By accruing expense in advance and creating a "reserve", the ability to
21 perform an audit or review of actual costs is improperly circumvented. The
22 individual "events" would not be open to review when they occur; instead, the

1 expense level necessary to achieve an adequate accrued “reserve” level to cover
2 ongoing costs would be considered in a future rate proceeding.

3 During future general rate cases, under an accrual or reserve method, the
4 audit or review would focus *only* on whether the expense level and the related
5 accrued “reserve” level are appropriate for future property damage or liability legal
6 proceedings and settlements. The accrued reserve would reflect reductions for costs
7 related to property damage or liability suits that would have occurred *prior* to the test
8 year, and thus, would not be available for review. In other words, past occurrences
9 of property damage and liability suit costs may make the reserve too low for ongoing
10 costs. The accrual or reserve method would not allow for the appropriate audit and
11 review of any past costs that inappropriately reduced the reserve. Instead, the focus
12 would be changed from a review of what was expensed in the test period for actual
13 occurrences of property damage and liability suits, to whether the reserve and current
14 expense level are deemed adequate to meet future occurrences. Such an approach is
15 inadequate and should be rejected.

16
17 **Q. Please summarize Staff’s recommendation.**

18 A. I recommend that the Commission accept Staff’s Adjustment 4.11, Liability Suits
19 and Property Damage. This adjustment reflects PacifiCorp’s decision to cease
20 captive insurance and replaces it with a normalized level of actual expense
21 experience based on captive claims activity. Accepting Staff’s approach would
22 allow for the adequate audit and review of costs as incurred. This adjustment
23 increases Washington net operating income by \$77,717 and reduces the revenue

1 requirement by \$125,304,⁴⁴ or a reduction of \$636,834 in revenue requirement
2 compared to PacifiCorp's proposed adjustment.⁴⁵

3
4 **VI. ADJUSTMENT 4.14, REGULATORY COMMISSION EXPENSE**

5
6 **A. Discussion**

7
8 **Q. Please explain what is included in FERC Account 928, Regulatory Commission**
9 **Expenses.**

10 **A.** The Code of Federal Regulations, title 18, part 1, section 101, states Account 928
11 Regulatory Commission Expense shall include:

12 "all expense....properly includible in utility operating expenses, incurred by
13 the utility in connection with formal cases before regulatory commissions, or
14 other regulatory bodies, or cases in which such a body is a party, including
15 payments made to a regulatory commission for fees assessed against the
16 utility for pay and expenses of such commission, its officers, agents, and
17 employees, and also including payments made to the United States for the
18 administration of the Federal Power Act.... The utility shall be prepared to
19 show the cost of each formal case."⁴⁶

20
21
22 **Q. Please provide some history on PacifiCorp's Washington Account 928,**
23 **Regulatory Commission Expense.**

24 **A.** Account 928, Regulatory Commission expense, for Washington has increased
25 considerably over the last two years. The following chart provides a five year

⁴⁴ Breda, Exhibit No. (KHB-4C) at 2:33.

⁴⁵ Id. at 6:59.

⁴⁶ Code of Federal Regulations, title 18, part 1, section 101, states Account 928 Regulatory Commission Expense. Exhibit No. (KHB-5C) at 4.

1 history on a Washington basis of total Account 928 expense, reflecting the year-
2 over-year increase and percentage increase.

3

Washington Account 928 Regulatory Commission Expense			
Year	Amount	Increase	Percentage
2006	\$ 556,394.00		
2007	614,173.00	\$ 57,779.00	10.4%
2008	655,931.00	41,758.00	6.8%
2009	1,032,326.00	376,395.00	57.4%
2010	<u>1,614,268.00</u>	581,942.00	56.4%
Total	<u>\$ 4,473,092.00</u>		
5/year Ave	\$ 894,618.40		

4
5
6 As depicted in the chart, Washington Account 928 Regulatory Commission
7 expense has increased significantly year-over-year. Washington's regulatory
8 commission expenses increased by 17.9 percent⁴⁷ from 2006 to 2008. The increase
9 in this two-year period is a significant increase in itself, but it pales in comparison to
10 the increase from 2008 to 2010. The increase for the latter period rises by an
11 incredible 146.1 percent!⁴⁸

12
13 **Q. Has PacifiCorp explained the increase in Regulatory Commission Expense?**

14 **A.** No. WUTC Staff Data Request Number 111⁴⁹ asked for a summary of regulatory
15 expense by Docket Number. The Company did not provide expense by docket

⁴⁷ $\$655,931 - \$556,394 = \$99,537 / \$556,394 = 17.9\%$.

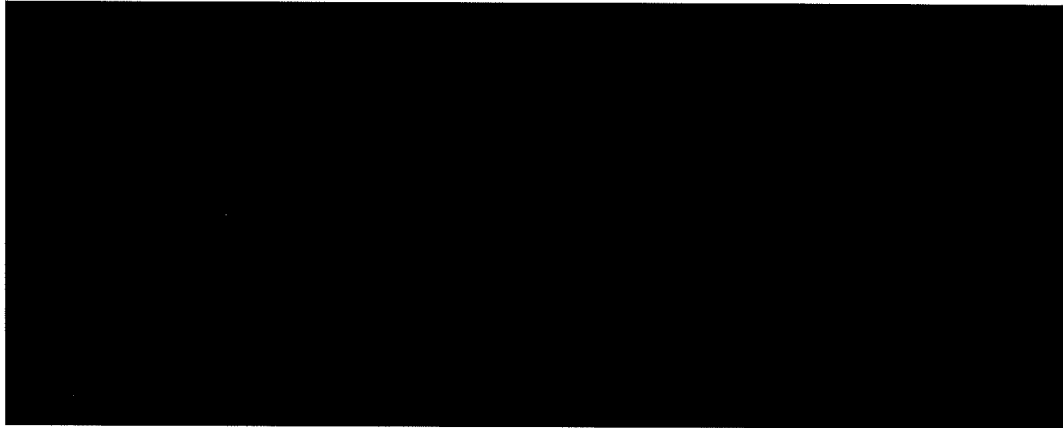
⁴⁸ $\$1,614,268 - \$655,931 = \$958,337 / \$655,931 = 146.1\%$.

⁴⁹ Exhibit No. (KHB-5C) at 9.

1 number.⁵⁰ The Company referred to its response to WUTC Staff Data Request
2 Number 80,⁵¹ which is summarized on page 11 through 15 of Exhibit No. (KHB-
3 5C).

4
5 **Q. Have you identified what has caused the significant increase in 2009 and 2010?**

6 A. Yes. Based on my analysis of the Confidential Attachment to WUTC Staff Data
7 Request No. 80, two profit centers appear to have charged additional expense to
8 Account 928, Regulatory Commission expense, in 2009 and 2010. The following
9 confidential chart reflects the expense for the last five years for Pacific Power
10 General Counsel and Regulatory External Affairs.



11
12
13 **Q. How did PacifiCorp respond when questioned about these two profit centers?**

14 A. WUTC Staff Data Request 95e⁵² asked "Please explain whether the Pacific Power
15 General Counsel and Regulatory External Affairs...is an additional expense for years

⁵⁰ Part 101 Account 928, as provided in Exhibit (KHB-5C) at 4, states "C. The utility shall be prepared to show the cost of each formal case."

⁵¹ Exhibit No. (KHB-5C) at 10 and at 12-16 summarizes the attachment to Confidential WUTC DR 80.

1 2009 and 2010 or a reclassification to Regulatory Commission Expense from another
2 expense account.” The Company responded by stating it is a reclassification as
3 follows:

4 “The legal and regulatory affairs expenses are a reclassification of charges
5 from FERC account 920 and 923 to 928.”
6

7 **Q. Does the information for Accounts 920 and 923 to 928 support PacifiCorp’s**
8 **response?**

9 A. No. PacifiCorp’s confidential response to WUTC Staff Data Request No. 100 does
10 not confirm their statement in response to WUTC Staff Data Request No. 95e. This
11 information⁵³, summarized below, clearly shows that Washington was charged an
12 additional amount in both 2009 and 2010 for Pacific Power General Counsel and
13 Regulatory External Affairs. There was not just a shift between accounts 920 and
14 923 to 928 for these profit centers. The detail is summarized as follows:



15
16
17 **Q. Is it reasonable to assume that PacifiCorp incurred greater Regulatory**
18 **Commission Expense in 2009 and 2010?**

⁵² Exhibit No. (KHB-5C) at 5 and 6.

⁵³ Breda Exhibit No. (KHB-5C) at 8.

1 A. Yes. PacifiCorp filed a Rate Case in 2009 and in 2010. In addition, there were rule
2 making and other dockets which could have increased this expense.

3

4 **Q. Do you have sufficient information to conclude that the test year, the twelve**
5 **months ended December 31, 2010, Account 928 Regulatory Commission**
6 **Expense, is reasonable?**

7 A. No. PacifiCorp has not provided docket or case detail to support the Washington
8 Account 928, Regulatory Commission Expense total of \$1,614,268 dollars included
9 in the test year.

10

11 **B. Staff's Proposed Adjustment, Conclusion and Recommendation**

12

13 **Q. Please explain Staff Adjustment 4.14, Regulatory Commission Expense.**

14 A. Adjustment 4.14, Regulatory Commission Expense, replaces Account 928 test year
15 actual expense dollars with a normalized level of expense based a three year average
16 for 2008 through 2010. Exhibit No. (KHB-5C), page 2 provides the detail this
17 calculation.

18

19 **Q. Please explain why three years are used for this average instead of the five years**
20 **provided earlier in your testimony?**

21 A. Although PacifiCorp did not provide sufficient information to analyze Account 928
22 Regulatory Commission expense, it is generally known that there has been, and will
23 likely continue to be, additional reporting requirements regarding renewable energy

1 portfolio standards as well as other requirements. While Staff is not convinced that
2 an increase from \$655,931 in 2008 to \$1,614,268 in 2010 for Washington regulatory
3 commission expense is reasonable, Adjustment 4.14 considers only a three year
4 average rather than five, giving some recognition to the increased regulatory
5 requirements that currently exist.

6
7 **Q. Do you feel this area needs more documentation by PacifiCorp and review by**
8 **Staff in the future?**

9 A. Yes. I expect that PacifiCorp would provide detailed information to Staff and others
10 allowing for the appropriate level of audit and review of this expense.

11
12 **Q. Please summarize your recommendation for Regulatory Commission Expense.**

13 A. I recommend the Commission accept Staff's Adjustment 4.14, Regulatory
14 Commission Expense, recognizing a reasonable level of expense for the test period.
15 This adjustment increases net operating income by \$248,489 and reduces revenue
16 requirement by \$474,806.

17
18 **VII. ADJUSTMENT 7.1, INTEREST TRUE-UP**

19
20 **Q. Please describe Adjustment 7.1, Interest True-Up.**

21 A. This adjustment synchronizes test period interest expense used to calculate income
22 tax with the interest provided through the cost of capital return computation. It is
23 accomplished by multiplying the weighted cost of debt by Washington's proposed

1 rate base amount. The difference between the Company's and Staff's adjustments is
2 attributable to the use of different rate base amounts since the debt ratio is the same.
3 My Exhibit No. (KHB-6) details the calculation of this adjustment.

4
5 **Q. What is the effect of Staff Adjustment 7.1, Interest True-Up?**

6 A. This adjustment reduces Washington's net operating income by \$405,903 and
7 increases revenue requirement by \$654,439.

8
9 **VIII. ADJUSTMENT 8.6, MISCELLANEOUS RATE BASE**

10
11 **A. Discussion**

12
13 **Q. Please explain PacifiCorp's Adjustment 8.6, Miscellaneous Rate Base.**

14 A. PacifiCorp's Adjustment 8.6, Miscellaneous Rate Base adjusts the rate base for items
15 not allowed for regulatory purposes: working capital, fuel stock, materials and
16 supplies, prepayments, and other miscellaneous rate base items.

17
18 **Q. Does PacifiCorp include deferred maintenance for Chehalis in the rate base?**

19 A. Yes. PacifiCorp does not remove a prepayment of maintenance expense for
20 Chehalis, which would typically be considered working capital.

21
22 **Q. Has PacifiCorp requested that Chehalis deferred maintenance be considered a**
23 **regulatory asset?**

1 A. No. PacifiCorp has not presented any testimony regarding deferred maintenance of
2 any plant.

3
4 **Q. Does the rate base include a regulatory asset for Chehalis?**

5 A. Yes. Adjustment 8.8 includes the remaining regulatory asset for Chehalis that was
6 established based on a stipulated amount from an all-party settlement in UE-
7 090205.⁵⁴ The amount included in the present Adjustment 8.6 was not approved for
8 deferral or recovery in UE-090205.

9
10 **B. Staff's Proposed Adjustment, Conclusion and Recommendation**

11
12 **Q. Please explain Staff's Adjustment 8.6, Miscellaneous Rate Base.**

13 A. Adjustment 8.6 removes an additional \$913,952 from Miscellaneous Deferred Debits
14 on a Washington basis from the rate base since it has not been authorized by the
15 Commission.

16
17 **Q. Please summarize your recommendation.**

18 A. I recommend the Commission accept Staff's Adjustment 8.6, Miscellaneous Rate
19 Base to properly reflect miscellaneous deferred debits and remove \$913,952 of
20 Chehalis deferred maintenance on a Washington basis.⁵⁵ This adjustment decreases

⁵⁴ *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-090205, Order 09, at 6, ¶¶ 15-16 (December 16, 2009).

⁵⁵ Breda Exhibit No. (KHB-7), Adjustment 8.6 Miscellaneous Rate Base.

1 net operating income by \$71,785 and reduces Washington rate base by \$21,439,738
2 for an overall reduction of \$2,559,778 in revenue requirement. This represents a
3 reduction of \$114,054 in revenue requirement compared to PacifiCorp's adjustment.

4 **Q. Does this conclude your testimony?**

5 A. Yes.