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-230172 ***(Consolidated)***
In the Matter of ALLIANCE OF WESTERN ENERGY CONSUMERS' Petition for Order Approving Deferral of Increased Fly Ash Revenues	DOCKET UE-210852 ***(Consolidated)***

CROSS-EXAMINATION EXHIBIT
OF MATTHEW MCVEE

ON BEHALF OF
SIERRA CLUB

EXHIBIT MDM-__X
ORDER 08, UE-061546 & UE-060817 (JUNE 21, 2007)

December 4, 2023

[Service Date June 21, 2007]

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-061546 ORDER 08 FINAL ORDER REJECTING TARIFF SHEETS; AUTHORIZING AND REQUIRING COMPLIANCE FILING
In the Matter of the Petition of PACIFIC POWER & LIGHT COMPANY For an Accounting Order Approving Deferral of Certain Costs Related to the MidAmerican Energy Holdings Company Transition.	)	DOCKET UE-060817 ORDER 08 FINAL ORDER GRANTING PETITION IN PART

Synopsis: The Commission rejects revised tariff sheets PacifiCorp filed on October 3, 2006, but authorizes and requires the Company to file tariff sheets stating rates that will recover approximately $14,189,025 in additional revenue based on an interjurisdictional cost allocation methodology that focuses on PacifiCorp's west control area, which includes Washington.[1] *The Commission rejects PacifiCorp's proposed power cost adjustment mechanism (PCAM) due to certain deficiencies in its design, but remains open to consideration of a more refined PCAM.*[2]

---

[1] The precise amount of the increase in revenue requirement may vary slightly from this approximation due to computational refinements to which the Company and Staff may agree as they prepare and review the Company's compliance filing to effect rates consistent with the requirements of this Final Order.
[2] A glossary of acronyms and terms used in this Order is attached for the convenience of readers.

TABLE OF CONTENTS

SYNOPSIS: **1**

SUMMARY **3**

PROCEEDINGS: 3
PARTY REPRESENTATIVES: 4
COMMISSION DETERMINATIONS: 4

MEMORANDUM **6**

I. BACKGROUND AND PROCEDURAL HISTORY 6
II. CONTESTED ISSUES 13
a. Interjurisdictional Cost Allocation *13*
b. Power Cost Adjustment Mechanism (PCAM) *16*
c. Net Power Costs *29*
i. Short Term Firm 30
ii. SMUD Contract 31
iii. Centralia Risk Sharing 33
iv. Georgia Pacific Camas Cogeneration 34
v. Hydro Normalization 34
vi. Thermal Ramping 35
vii. Regulating Margin 36
d. Revenue Requirements *37*
i. Federal Tax Disallowance 37
ii. IRS Settlement 40
iii. Working Capital 41
iv. MEHC Transition 43
v. Pension Expense 45
vi. Incentive Compensation 46
vii. Health Care 47
viii. A&G Expense Cap 47
ix. Management Fee 48
e. Low-Income Program *48*
f. MEHC Commitments *50*
g. Prudence of Resource Acquisitions *50*
h. Rate Spread and Design *51*

FINDINGS OF FACT **51**

CONCLUSIONS OF LAW **52**

APPENDIX **56**

GLOSSARY **60**

SUMMARY

PROCEEDINGS:

1 On October 3, 2006, PacifiCorp d/b/a Pacific Power & Light Company (PacifiCorp or Company) filed with the Washington Utilities and Transportation Commission (Commission) revisions to its currently effective Tariff WN U-74. The Company based its filing on a twelve month test period ended March 31, 2006. PacifiCorp asserted a revenue deficiency of $23.2 million, which would require a rate increase of 10.2 percent for full recovery, according to the Company. The filing, if allowed to go into effect, would have increased PacifiCorp's rates and charges for electric service to customers in the state of Washington by the indicated amount on the stated effective date of the revised tariff pages, November 2, 2006. PacifiCorp, however, asked the Commission to enter an order suspending the revised tariff pages without consideration at an open public meeting. The Commission suspended operation of the tariffs by Order 01 entered on October 10, 2006. The suspension date under RCW 80.04.130 is September 2, 2007.[3]

2 On February 16, 2007, Commission regulatory staff (Staff), the Public Counsel Section of the Washington Office of the Attorney General (Public Counsel) and the intervening parties filed their respective response testimonies. On March 5, 2007, PacifiCorp filed its rebuttal testimony and Staff filed cross-answering testimony disputing various points made by Public Counsel and Industrial Customers of Northwest Utilities (ICNU) witnesses in their response testimonies.

3 The Commission provided members of the public a continuing opportunity throughout the proceeding to submit written comments concerning the Company's request and held a public comment hearing to take oral comments in Walla Walla, Washington on March 2, 2007.[4] The Commission conducted evidentiary hearings in Olympia, Washington on March 27, 2007. The parties filed initial briefs on April 24, 2007, and reply briefs on May 8, 2007.[5] The Commission resolves the disputed issues and determines the Company's revenue requirement in this Final Order, as summarized in Appendix A.

---

[3] The suspension date is the date on which the revised tariff sheets become effective as a matter of law absent affirmative waiver by the company or entry prior to the suspension date of a Commission final order accepting or rejecting the as-filed tariff pages. If the Commission rejects the as-filed tariff pages, it may leave the company's existing rates unchanged or may order a filing by the company to effect new rates that comply with the Commission's determinations in its final order.

[4] The Commission received into the record 81 written public comments, 79 of which stated opposition to the proposed rate increase.

[5] The parties submitted their initial and reply briefs electronically one day prior to the indicated filing dates.

PARTY REPRESENTATIVES:

4 James M. Van Nostrand, Perkins Coie LLP, Portland, Oregon, represents PacifiCorp. Melinda J. Davison and Irion Sanger, Davison Van Cleve, P.C., Portland, Oregon, represent ICNU. Brad M. Purdy, attorney, Boise, Idaho, represents The Energy Project. Simon ffitch, Assistant Attorney General, Seattle, Washington, represents Public Counsel. Donald T. Trotter, Assistant Attorney General, Olympia, Washington, represents Staff.[6]

COMMISSION DETERMINATIONS:

5 The Commission approves the Company's proposed west control area interjurisdictional cost allocation methodology, subject to certain modifications proposed by Staff. The Commission determines that the Company's as-filed rates do not meet the statutory fair, just, reasonable and sufficient standard for approval. However, resolving various contested issues, as summarized in Table 1, the Commission determines that PacifiCorp should be authorized and required to file revised tariff sheets effecting rates on the basis of an increase in revenue requirement of approximately $14,189,025 and otherwise complying with the determinations we make in this Order.

6 We find PacifiCorp faces sufficient volatility in power costs to justify approval of a power cost adjustment mechanism, but we reject PacifiCorp's proposal in this case, finding it deficient in its design.

7 In addition, we find appropriate an increased funding level for PacifiCorp's low income bill assistance program; find certain merger commitments satisfied and find prudent certain investments the Company has made in generation.

---

[6] In formal proceedings, such as this case, the Commission's regulatory staff functions as an independent party with the same rights, privileges, and responsibilities as any other party to the proceeding. There is an "*ex parte* wall" separating the Commissioners, the presiding Administrative Law Judge, and the Commissioners' policy and accounting advisors from all parties, including Staff. *RCW 34.05.455.*

TABLE 1
Summary of Commission Determinations

INTER-JURISDICTIONAL COST ALLOCATION	Commission Determination
Should the Commission approve the West Control Area (WCA) allocation methodology as proposed by PacifiCorp, with Staff's modifications?	YES
POWER COST ADJUSTMENT MECHANISM (PCAM)	**Commission Determination**
Should the Commission approve a PCAM for PacifiCorp?	NOT AT THIS TIME
POWER COSTS	**Commission Determination**
Should the Commission accept ICNU's recommendation to remove the costs of short term firm transactions?	NO
Should the Commission remove the Sacramento Municipal Utility District (SMUD) contract cost and imputed revenues from net power costs?	NO
Should the Commission accept ICNU's recommendation to require PacifiCorp's shareholders to absorb one-half of the cost of replacement power required as a result of the sale of the Centralia facilities?	NO
Should the Commission accept ICNU's recommendation to adjust net power costs downward to reflect the historical generation purchased from the "GP Camus" cogeneration facility?	NO
Should the Commission accept ICNU's recommendation that the hydro normalization calculation use filtered water years?	NO
Should the Commission accept ICNU's recommendation to reverse a Company adjustment to outage rates used in the GRID model?[7]	YES
Should the Commission accept ICNU's recommendation to reverse PacifiCorp's adjustment of "Regulating Margin" in the GRID model to 225 MW from the 125 MW margin previously used?	YES
Should the Commission accept ICNU's recommendation to normalize line losses?	YES
REVENUE REQUIREMENT ISSUES	**Commission Determination**
Should the Commission accept ICNU's proposed Federal Income Tax disallowance?	NO
Should the Commission accept Staff's proposed IRS Settlement Amortization disallowance?	YES
Should the Commission accept either PacifiCorp or Staff's calculation of working capital?	NO
Should the Commission accept ICNU's proposed disallowance of all MidAmerica Energy Holding's Company (MEHC) Transition costs? Should the Commission accept Staff's proposed disallowance of some MEHC Transition costs?	NO YES
Should the Commission accept ICNU's proposed adjustment to Pension Expense?	NO
Should the Commission accept ICNU's proposed adjustment to Incentive Compensation?	NO
Should the Commission accept ICNU's proposed adjustment to Health Care expense?	NO
Should the Commission accept ICNU's proposed adjustment to A&G Expense?	NO
Should the Commission accept ICNU's proposed adjustment to Management Fees?	NO

[7] GRID is a third party proprietary computer model that PacifiCorp uses to project power costs.

RATE OF RETURN

Component	Share (%)	Cost (%)	Weighted Cost
Equity	46.00	10.200	4.692
Long-term debt	50.00	6.335	3.168
Short-term debt	3.00	4.500	0.135
Preferred	1.00	6.455	0.065
Overall Rate of Return			**8.060** [8]

	Commission Determination
LOW INCOME PROGRAM	
What surcharge amount should the Commission approve for Schedule 91 to fund PacifiCorp's Low Income Bill Assistance program	$0.40
MEHC COMMITMENTS	
Should the Commission find PacifiCorp has satisfied certain commitments made at the time of its acquisition by MEHC?	YES
PRUDENCE OF RESOURCE ACQUISITIONS	
Should the Commission find prudent PacifiCorp's investments in certain power assets?	YES
RATE SPREAD / RATE DESIGN	
Should the Commission approve and adopt the parties' agreed rate spread and rate design?	YES

MEMORANDUM

I. Background and Procedural History

8 On October 3, 2006, the Company filed tariff revisions to increase its annual electricity sales revenue by $23.2 million or 10.2 percent. PacifiCorp asked for, among other things, approval of an interjurisdictional cost allocation methodology that allocates costs to Washington using the so-called West Control Area method (WCA), a Power Cost Adjustment Mechanism (PCAM), an update to power costs and other cost items, a determination that the Company has met certain obligations under commitments it made at the time of its acquisition by MidAmerican Energy Holdings Company (MEHC) and a determination that it's acquisition of certain power supply contracts and facilities was prudent. According to the Company's advice letter, its request for added electricity revenue would increase the monthly average bill for its 100,091 residential electric customers by $8.51 per month or 10.8 percent.

9 PacifiCorp's initial request was based on:

- A test-year ending March 2006.

[8] This number reflects internal rounding. The more precise number is 8.05905 percent, which the Commission used in formulating Appendix A to this order.

- An overall rate of return of 8.057 percent.
- A rate of return on common equity of 10.2 percent.
- A capital structure with 46 percent common equity and 50 percent long-term debt.
- A rate base of $554.5 million based on the WCA method.
- Total net operating income of $44.7 million.

10 According to the Company, it is currently earning a return on equity (ROE) in Washington of 4.54 percent for the test period rather than the currently authorized 10.2 percent ROE. PacifiCorp contended the requested increase of $23.2 million in the Company's revenue requirement would be required to produce the authorized ROE. Ms. Kelly testified for the Company that the main driver behind the asserted revenue deficiency is increased power costs to serve growing retail load requirements in Washington. She related in her testimony that Mr. Widmer's analyses for the Company show a near doubling in Washington's share of net power costs relative to what the Commission approved in 2004.

11 PacifiCorp proposed in its filing to implement an interjurisdictional cost allocation based on identification of a West Control Area established via discussion with Staff and others. The approach adopted purports to address the concerns expressed in the Commission's order rejecting the interjurisdictional cost allocation method called the Revised Protocol PacifiCorp proposed in its 2005 Rate Case.[9] The WCA method eliminates all resources and loads in the east control area, though it does include certain resources that serve but are not physically located in the WCA states (Washington, Oregon and California). PacifiCorp proposes to implement this interjurisdictional cost allocation on a five-year pilot basis with periodic evaluation and adjustment, if appropriate.

12 The Company limited the number of pro forma adjustments included in its as-filed case. Only adjustments applicable to the WCA method were included and allocated to Washington. Adjustments for major resource additions were excluded, except for the power purchase agreement with Eurus Oregon Wind Power Development LLC

---

[9] *Washington Utilities and Transportation Commission v. PacifiCorp d/b/a Pacific Power and Light Company*, Docket UE-050684 (Order 04*); In the Matter of the Petition of PacifiCorp d/b/a Pacific Power and Light Company for an Accounting Order For an Order Approving Deferral of Costs Related to Declining Hydro Generation*, Docket UE-050412 (Order 03) (consolidated) (Apr. 17, 2006) ("2005 Rate Case Order"). PacifiCorp is a multi-state utility providing service in two control areas. The east control area includes portions of Utah, Idaho and Wyoming. The west control area includes portions of Washington, Oregon and California.

(Eurus), the purchase of Leaning Juniper Wind Power, LLC, (Leaning Juniper), and the Grant County Public Utility District (PUD) power purchase agreement. The Company requested that the Commission find these resource additions prudent and used and useful for service to Washington. The filing did not include adjustments for pro forma wages and benefits[10] or O&M expenses. In addition, the Company elected not to re-litigate issues decided by the Commission in the 2005 Rate Case, such as cost of capital issues.

13 Specifically, the Company's as-filed case:

- Accepts the Commission-authorized cost of equity and capital structure but updates cost of capital to reflect a decrease in the cost of long-term debt and preferred equity, which reduces the Company's authorized rate of return from the 8.10 percent authorized in the Company's 2005 Rate Case to 8.057 percent.

- Implements the interim methodology for temperature normalization to which the parties stipulated in the 2005 Rate Case.

- Removes all miscellaneous deferred debits not previously authorized by the Commission.

- Follows the Commission-ordered accounting for the Malin-Midpoint safe-harbor lease.

14 PacifiCorp proposed to use the rate spread methodology agreed to by all parties from the 2005 Rate Case. The Company updated its cost of service study but the results were similar to those filed in 2005. PacifiCorp proposed in its filing to increase the tariff supporting its low income bill assistance program by the cumulative percentage increase in rates since the inception of the program approximately six years ago, including any increase resulting from this rate case,.

15 The Company incorporated expense adjustments related to its change in ownership in two categories: (1) implementation of transaction commitments, and (2) inclusion of known and measurable transition benefits net of an amortization of transition costs. The adjustments result in a $1.8 million reduction in revenue requirement.

16 PacifiCorp proposes to implement a PCAM to deal with volatility in power costs, which it describes as similar to Avista's Energy Recovery Mechanism (ERM) previously approved by the Commission.

---

[10] Staff, however, recommended through Mr. Schooley an adjustment to pro forma wages and benefits to which the Company agreed.

17 On January 17, 2007, the Company, Staff and the Energy Project proposed a multiparty settlement of many, but not all issues raised by the Company's filing. The Company and Staff agreed on a number of issues including the WCA cost allocation with certain modifications, a revenue requirement increase of $10 million effective April 1, 2007, and a bifurcated process to address the design and implementation of a PCAM and update to power costs as a second phase in this docket. PacifiCorp, Staff and the Energy Project agreed to increase the Low Income Bill Assistance program as proposed in the Company's filing. The settling parties proposed a modification of the procedural schedule to accomplish the rate increase and proposed bifurcation of the issues.

18 ICNU and Public Counsel, in a joint filing, opposed the multiparty settlement and the proposed changes to the procedural schedule, asserting due process concerns. ICNU and Public Counsel also opposed separating consideration of the proposed PCAM from the remainder of the case, asserting that "the cost allocation methodology, overall level of power costs assumed in rates, and PCAM involve related issues, and should be considered at the same time."

19 The Commission declined to modify the procedural schedule or to consider separately the PCAM issue. The settling parties withdrew the proposed multiparty settlement on January 30, 2007.

20 On February 9, 2007, the Commission granted an unopposed motion to consolidate Docket UE-060817 into the rate proceeding. Docket UE-060817 was initiated by PacifiCorp's Petition for Accounting Order (Petition) filed on May 19, 2006. According to paragraph 4 of the Petition, PacifiCorp seeks "an accounting order authorizing capitalization of the [merger related] transition costs through March 2007," followed by an amortization period beginning April 1, 2007, or "at the implementation of the next general rate case."[11] Among other things, these transition costs relate to severance payments PacifiCorp made to departing employees, and the cost of new software, all occasioned by the recent acquisition of PacifiCorp by MidAmerican Energy Holdings Company.

21 On February 16, 2007, Staff, Public Counsel, ICNU and the Energy Project filed their respective response testimonies.

[11] Docket UE-061546 is the "next general rate case" referred to in PacifiCorp's accounting petition in Docket UE-060817. In the general rate case, PacifiCorp is proposing an accounting adjustment that reflects in the Company's proposed rates the accounting treatment for transition costs that the Company seeks in its Petition. Various parties to the general rate case have conducted discovery on this proposed adjustment, according to the joint Motion.

22 Staff recommends approval of the WCA cost allocation with two modifications. In addition, Staff recommends five adjustments to the Company's proposed net power costs totaling $3.1 million if a PCAM is adopted and $1.52 million if a PCAM is not adopted.[12]

23 Staff supports approval of a PCAM, but only with a number of conditions including modifications to the dead-band and sharing bands; use of truncated water records to normalize power costs; and an adjustment reducing the equity share in the Company's approved capital structure from 46 to 42 percent to reflect Staff's measurement of the amount of risk reduction produced by Staff's proposed PCAM. The capital structure adjustment would reduce PacifiCorp's overall return to 7.90 percent and the Company's revenue requirement by about $3 million.

24 Staff recommends that the Commission expressly find prudent the Eurus contract, acquisition of the Leaning Juniper 1 wind project, and the new contracts with Grant County PUD.

25 Finally, Staff recommends rejection of the Company's proposal to amortize the costs of an IRS settlement payment related to taxes paid in prior tax years, five adjustments to working capital in ratebase and five adjustments to expense items.

26 Altogether, Staff recommended the Commission approve a $12,744,727 increase in rates if the Commission authorizes a PCAM, or $15,964,473 if no PCAM is authorized.[13] Staff slightly modifies its results on brief and recommends a $12,324,911 increase if the Commission approves a PCAM for the Company.

27 Neither ICNU nor Public Counsel presented a complete revenue requirement analysis or a specific recommendation regarding an increase or decrease in the Company's rates.[14] In joint testimony ICNU and Public Counsel state:

> As in Docket No. UE-050684, the Commission could reject the Company filing, and refuse to grant the requested rate increase. However, for reasons that will be discussed shortly, this may actually be an overly generous treatment for the Company because even the most obvious corrections to the WCA and GRID models support a reduction in rates for the Company.

---

[12] The difference is attributable to the Staff's recommendation to use a truncated water record for normalizing power costs if a PCAM is implemented.

[13] These are Staff's figures after slight modifications in its cross answering testimony to correct an error in its adjustment 4.9 – A&G Expense Commitment.

[14] On Briefing, ICNU recommends that PacifiCorp's current rates should be reduced by "up to $29.1 million." ICNU Brief ¶ 1

28 ICNU and Public Counsel jointly oppose the WCA method as proposed by the Company. On brief, they propose four modifications to the method which in total reduce costs allocated to Washington by $13.20 million (Net Operating Income or NOI). The bulk of this adjustment consists of estimates of benefits that these parties argue result from integration with the east control area. ICNU and Public Counsel contend these modifications are necessary to comply with the Commission's "used and useful standard." According to ICNU and Public Counsel's witness, Mr. Falkenberg, the Company's proposed WCA is:

> A shallow attempt to court favor with the Commission by trading simplicity for higher cost to customers. I recommend the Commission either substantially modify the model or reject it out of hand, as it did with the Revised Protocol model in Docket No. UE-050684.

29 In addition to their proposed modifications to the WCA, ICNU and Public Counsel recommend eight adjustments to the Company's power cost modeling that in aggregate reduce net power costs in Washington by and additional $9.45 million (NOI).

30 ICNU also proposes $7.04 million (NOI) in downward adjustments to the Company's expenses. These adjustments focus on: labor and software costs associated with the MEHC transition; pension expenses; executive and non-executive incentive pay; and health care benefits.

31 Contending that the Company should only collect an expense for income taxes equal to what will "likely" be paid to taxing authorities, ICNU recommends that the Company's federal income tax expense be reduced by $1.9 million (NOI) to capture an alleged tax-benefit attributable to debt in MEHC's capital structure.

32 With regard to the Company's proposed PCAM, ICNU and Public Counsel present separate testimonies. Both parties argue generally that the Company has not proven that a PCAM is necessary and both parties oppose the Company's specific proposal.

33 ICNU recommends that if a PCAM is approved, the Company's return on equity should be reduced by 30 basis points. As an alternative to the Company's proposed PCAM, ICNU recommends what it describes as a hydropower production "hedge contract" between the Company and its customers.

34 Public Counsel opposes any PCAM mechanism for PacifiCorp contending the Company has not established a need for such a mechanism.

35 The Energy Project recommends that the Company's low income assistance program be increased to provide benefits to low income customers comparable in magnitude to

the proportion of Company revenues represented by such programs at Puget Sound Energy and Avista. The Energy Project takes no position on the WCA, net power costs, PCAM or the Company's revenue requirement.

36 On March 5, 2007, the Company filed rebuttal testimony and Staff filed cross-answering testimony.

37 On rebuttal, the Company accepts the two WCA modifications proposed by Staff and four of the five adjustments to power costs. The Company opposes Staff's adjustment 5.6 that would statistically filter water-years and offers an alternative. In addition, the Company accepts a number of expense and ratebase adjustments recommended by Staff. It reduces its requested revenue increase to $19.05 million (8.4 percent). On brief, PacifiCorp reduces the amount further to $18.58 million.

38 The Company contests Staff's adjustments that would reduce the amounts of MEHC transition savings and working capital in ratebase.

39 With regard to the PCAM, the Company is willing to accept the Staff's proposals concerning deadband, sharing bands and accounting periods. PacifiCorp proposes an alternative to the truncated water record adjustment. It offers to exclude fixed production costs for new resources from the PCAM, but only if the Commission authorizes a "power cost only rate case" mechanism. The Company, however, does not offer any proposal or detail for such a mechanism. Finally, the Company opposes the Staff's adjustment to capital structure and overall rate of return to reflect risk reduction if a PCAM is approved and requests that the Commission allow it to withdraw its PCAM proposal if this condition is required.

40 The Company accepts the proposal to change the Control Area Energy—West (CAEW)[15] and System Overhead (SO) allocation factors to a 75 percent demand/25 percent energy ratio, but rejects all of the modifications to WCA and net power costs proposed by ICNU and Public Counsel, and all of ICNU's adjustments to expenses. The Company also opposes ICNU's proposed income tax expense adjustment and its PCAM-related adjustment to return on equity.

41 In cross-answering testimony, the Staff responds to the ICNU and Public Counsel recommendations agreeing with the 75 percent demand/25 percent energy allocation factor (CAEW and SO) for fixed production costs. Staff also agrees to a truncated water record adjustment, but only if tied to approval of a PCAM. Staff opposes all of the other WCA modifications recommended by ICNU and Public Counsel. Staff opposes the ICNU and Public Counsel net-power-cost adjustments related to short-

[15] Staff uses the nomenclature Control Area Generation—West (CAWG) for this allocation factor. *See* Staff Initial Brief ¶25.

term firm transactions, and the SMUD contract. On brief, Staff takes no position on other net power cost adjustments proposed by ICNU and Public Counsel.

42 Staff opposes ICNU's adjustments to expenses and ICNU's recommended adjustment to income tax expense. Staff also opposes ICNU's proposed PCAM-related risk adjustment to return on equity.

II. Contested Issues

a. Interjurisdictional Cost Allocation

43 We approve PacifiCorp's proposed West Control Area (WCA) interjurisdictional cost-allocation for Washington modified by our adoption of Staff's adjustments 5.4 and 5.5. We approve the Company's recommended five-year trial period and Staff's recommended "oversight committee." We reject all other proposed modifications to the WCA.[16]

44 The WCA includes the California, Oregon and Washington loads and resources.[17] Some of these generation resources, such as Colstrip and Jim Bridger, are located outside Washington, Oregon and California, but adequate transmission is available for these resources to provide delivery to Washington customers.[18] The WCA method isolates the costs associated with these assets, purchases and sales, and allocates to Washington a proportionate share of the costs based on Washington's relative contribution to the WCA's demand and energy requirements.[19] Under the Company's proposed WCA method, Washington's share of the WCA-related costs for the test period is approximately 22 percent.[20] The Company proposes a five-year evaluation period for the WCA method.

45 Staff supports PacifiCorp's proposed WCA method with two modifications.[21]

- Staff Adjustment 5.4 imputes benefits to the WCA from market sales to the east control area considering transmission availability and market prices. The

---

[16] ICNU includes under the rubric of interjurisdictional cost allocation a proposed normalizing adjustment for line losses. This does not really implicate the allocation issue. ICNU's proposed line loss adjustment is more properly a subject under power cost or revenue requirement, where we will discuss it as a factor potentially affecting net operating income.
[17] Exhibit 11 at 3:22-4:10 (Kelly). The WCA also includes Company-owned generating resources such as the West hydroelectric resources, Hermiston, Colstrip, and Jim Bridger as well as wholesale contracts like the Bonneville Power Administration Peak Purchase contract and the Mid-Columbia hydro contracts. *Id.*
[18] *Id.* at 4:10-13.
[19] *Id.* at 4:13-16. In its rebuttal testimony, the Company agreed to utilize a 75 percent demand/25 percent energy allocation factor for fixed costs of generating resources. Exhibit 136 at 3:13–4 (Wrigley Rebuttal).
[20] Exhibit 11at 4:16-17 (Kelly).
[21] Exhibit 261 at 3 (Buckley).

Company accepts this adjustment subject to it being further scrutinized in the future.[22]

- Staff Adjustment 5.5 modifies the allocation of fixed production costs in the CAGW (a/k/a CAEW) and SO allocation factors to be 75 percent demand-related and 25 percent energy-related. The Company, ICNU and Public Counsel all agree to this adjustment.

46 With the modifications it proposes, Staff testifies that the WCA "meets the standards enunciated by the Commission" and "is appropriate for purposes of setting retail electric rates for PacifiCorp's Washington customers."[23] Staff recommends a formal five-year period for reviewing the effectiveness of the WCA methodology and that the Commission should establish a "Monitoring Committee" to develop refinements to the WCA for consideration in future proceedings.[24]

47 Staff contends that the WCA methodology "reflects a common sense application of the used and useful standard" because:

- It is based on the resources used to support the west control area, which includes Washington.

- It allows for direct assignment of resources outside the west control area if transmission capacity to the west control area exists.

- It allows for indirect inclusion of eastside benefits and costs if purchases or sales between the control areas are economic.[25]

48 Staff agrees with PacifiCorp that while both Colstrip and Jim Bridger are located in the east control area, they are appropriately included in the WCA method because the plants have access to sufficient transmission capacity to serve both the east and west control areas and have associated transmission facilities designed to serve Washington. Staff contends that the WCA method also includes the full benefit and cost of hydroelectric resources within the west control area.[26]

---

[22] PacifiCorp agrees to Staff's adjustment 5.4 (eastern market modification) subject to the condition that the "monitoring committee" will review the eastern market adjustment in the future and propose modifications, if appropriate. PacifiCorp Initial Brief ¶9.
[23] Staff Initial Brief ¶ 13.
[24] Exhibit 261 at 5-6 and 13 (Buckley).
[25] Staff Initial Brief ¶¶ 16-22.
[26] *Id.* ¶¶ 23-24.

49 ICNU and Public Counsel oppose the WCA method as it is proposed by the Company.[27] According to ICNU, the WCA is simplistic and assumes there are no interconnections between the west and east control areas thereby overstating costs to serve Washington customers.[28] ICNU is simply wrong in this assertion. As already discussed, PacifiCorp has included the benefits of generators located in the east control area to the degree that transmission exists to serve the WCA.

50 ICNU contends the WCA results in markedly higher power costs in Washington, relative to the east control area states. ICNU's analysis is incorrect because it does not consider fixed costs. When fixed costs are included, we find power costs in the WCA are only 1.2 percent higher than in the east control area, not 62 percent higher as ICNU contends. PacifiCorp states this modestly higher cost is because the WCA must meet a higher proportion of its retail load with market purchases than is the case in the east control area.

51 ICNU contends that the WCA allocates all of the costs of the west control area to Washington customers, but none of the power-cost-related benefits of PacifiCorp's operation as an integrated company. In addition, ICNU argues that certain low-cost legacy coal-fired resources (*i.e.,* Dave Johnson and Wyodak) located in the east control area are not included in the WCA even though they were included in the Company's Washington rates in the past. According to ICNU, PacifiCorp has "distorted" the Commission's "used and useful test" by failing to include the indirect benefits of system integration in WCA.[29]

52 The interconnection benefit modifications proposed by ICNU incorrectly assume that transmission capacity exists for the WCA to make sales to the east control area in the Southwest rather than at mid-Columbia. This capacity is not available, and any associated cost has not been included in the WCA, because the capacity is already contractually obligated to the Idaho Power Revised Transmission Service Agreement used to move east control area power between the Bridger coal plant and Utah.[30]

53 Based as it is on the generation resources that are actually used to keep the west control area in balance with its neighboring control areas, the WCA method is a solid foundation for determining the resources that actually serve load in Washington. Staff's adjustment 5.4 is a reasonable estimate that relies on practical and

---

[27] ICNU Initial Brief ¶ 11 and Exhibit 161 at 14-15 (Falkenberg). Public Counsel adopts ICNU's brief on this issue. Our references to ICNU in this section include Public Counsel.
[28] *Id.*
[29] ICNU, after arguing in the last case that a system-wide allocation would require Washington to bear the costs of growth in Utah and the east control area, now seeks to capture the benefits of integration, apparently without the costs. ICNU's imputation of the value of power from the Johnston and Wyodak plants without inclusion of any of the capital costs in rate base is a good example.
[30] PacifiCorp Initial Brief ¶¶ 18-19

understandable assumptions to calculate the additional value that sales to the east can provide to customers in the WCA.

54 By contrast, ICNU's imputations of \$3.7 million in integration benefits and \$1.2 million of operating reserve benefits are speculative and rely on arbitrage between market hubs that may not be physically possible.

55 ICNU's imputation of value from the Johnston and Wyodak coal plants rests on the incorrect assumption that because these plants were once allocated to Washington, they should be so today. Staff is correct to point out that the past allocations applied to a different company (*i.e.*, Pacific Power and Light prior to merger with Utah Power) which controlled different assets, had different loads and therefore required a different interstate allocation method. We find persuasive Staff's conclusion that this history does not prove that under the changed circumstances the plants continue to be used and useful for serving Washington load except under very limited off-peak conditions.

56 It appears to us that PacifiCorp and Staff expended considerable effort to design an interjurisdictional cost allocation method that meets the criteria in our 2005 Rate Case order. The method is straightforward and easy to understand. It is flexible enough to accommodate allocation of indirect benefits and costs when they are quantified and demonstrated.

57 We find the WCA cost-allocation for Washington, modified by our adoption of Staff's adjustments 5.4 and 5.5, produces results that are consistent with the requirements for an allocation methodology that we have discussed in prior orders, particularly our Final Order in PacifiCorp's 2005 Rate Case. It is in the public interest for us to approve the WCA method. We reject all other modifications proposed by ICNU and Public Counsel.

58 We also approve the Company's recommended five-year trial period and Staff's recommended "oversight committee." We will not be prescriptive as to the process, but we do expect that it will be inclusive and open to participation by the parties in this proceeding and the broader community interested in PacifiCorp's rates.

b. Power Cost Adjustment Mechanism (PCAM)

59 PacifiCorp seeks approval to implement a PCAM that it argues is justified because the Company faces volatility in net power costs and because Avista and PSE have power cost adjustment mechanisms.[31] We find, as discussed below, that PacifiCorp's circumstances include significant exposure to variability in power costs and this

[31] Exhibit 11 at 11-12 (Kelly); Exhibit 81 at 26-34.

variability is sufficient to justify a PCAM. However, PacifiCorp has designed its mechanism on the basis of the PCAM we approved for Avista, the so-called ERM, without making refinements that our record shows are appropriate in light of PacifiCorp's unique circumstances. Specifically, we find that the design features proposed by the Company and modified by Staff do not appropriately balance risk and benefits. There are two principal reasons:

- The accounting for actual and computer-generated-actual costs has not been shown to be reliable.

- The design of the deadband and sharing bands should reflect the asymmetry of power cost risk that is evident in PacifiCorp's case.

60 We do not foreclose the possibility that the Commission will approve a PCAM for PacifiCorp, we simply do not find the present record provides an adequate basis upon which to do so. If, within 12 months after the date of this Order, the Company elects to file a petition seeking approval of a PCAM consistent with the guidance we provide here and with or without a request for authority to file power cost only rate cases (PCORCs), we will consider it outside the context of another general rate case. Any request the Company makes seeking such authority later than 12 months from now must be in the context of a general rate case.

61 Staff agrees with the Company that a PCAM is justified, but recommends a number of changes to the mechanism PacifiCorp proposes. Staff also recommends modifications to normalized net power costs to eliminate extreme water years and an adjustment to the Company's capital structure that reduces its overall authorized rate of return, nominally to reflect risk reduction.[32]

62 ICNU concedes the Company faces variability in power costs, but recommends that we reject the Company's proposed PCAM, even with the modifications proposed by Staff. ICNU argues the Commission should reconsider adoption of a PCAM only after experience is gained with "an appropriate cost allocation methodology."[33] In the alternative, ICNU recommends that the Commission approve a PCAM that is focused narrowly on variability in hydro-generation and that includes a 30 basis point downward adjustment to the Company's return on equity.[34]

63 Public Counsel opposes approval of any PCAM arguing that PacifiCorp does not face variability in net power costs sufficient to justify such a mechanism. Public Counsel,

---

[32] Staff Brief ¶ 45 and ¶ 96; Exhibit 261 at 26:21-27:4, 34:18-23 (Buckley).
[33] ICNU Brief ¶¶ 41 and 47; Exhibit 161 at 69:10-16 (Falkenberg). We note that in the context of ICNU's argument that the WCA does not represent an "appropriate cost allocation methodology," this suggested reconsideration would await development of yet another allocation methodology and not be anytime soon.
[34] ICNU Brief ¶ 53.

like ICNU, recommends that the Commission defer further consideration of a PCAM for PacifiCorp until it has gained experience with a cost allocation methodology.[35] In the alternative, Public Counsel says that either the PCAM recommended by Staff or by ICNU would be more acceptable than the Company's proposal.[36]

64 Pacificorp is willing to accept Staff-recommended modifications to the deadband, sharing bands, water-year adjustment, removal of fixed-cost component, and $6 million threshold for cost recovery under the following two conditions:[37]

- Acceptance of the Company's modifications to the Staff's proposed water-year adjustment (Adjustment 5.6).[38]
- Authorization to file a proposal to implement an annual power-cost-only adjustment mechanism.[39]

65 PacifiCorp opposes any adjustment to its cost of capital and purports to reserve the right to withdraw its request for a PCAM if it finds any terms imposed by the Commission unacceptable.[40]

66 Table 2 presents the key design elements and other features of the PCAMs proposed in our record.

TABLE 2
PCAM Proposals

	Deadband	Sharing Bands	Other Features	Risk-Adjustment
PacifiCorp	+/-$3 M	+/- $3- 7.4M 60% customer >$7.4M 90% customer	Include fixed cost for new resources ≤50 MW for ≤2-year term; Retail Load Adjustment; $3 M threshold for cost-recovery.	None
Staff	+/-$4M	+/- $4 – 10M 50% customer >$10M 90% customer	No fixed cost for new resources (only variable cost); Retail Load Adjustment; $6 M threshold for cost-recovery.	Reduction in equity component of capital structure to 42% [ROR = 7.90]
ICNU	+/-$8.6 M	+/- $8.6 – 17.3M 50% customer > $17.3 85% customer	No other detail	ROE reduction of 30 basis points [ROR = 7.92]

[35] Public Counsel Brief ¶ 38; Exhibit 241 at 2:9-3:9 (Johnson).
[36] Public Counsel Reply Brief at ¶ 4.
[37] PacifiCorp Brief ¶ 24.
[38] We discuss this below at ¶¶ 88-101.
[39] On Brief, the Company states "If *approval* of an *annual* true-up mechanism is received, the Company would adopt Staff's recommendation to remove the fixed production cost component of the PCAM." (emphasis added)
[40] PacifiCorp Brief ¶ 29 ; Exhibit 12 at 3:22-4:10

67 The PCAM issue presents five interrelated questions:

- Do PacifiCorp's circumstances establish the need for a PCAM?
- Is it practical and appropriate to approve a PCAM in this case?
- Are the designs proposed for the PCAM appropriate for PacifiCorp?
- Are adjustments to the water-record used for normalization necessary?
- Are risk-adjustments to cost of capital necessary?

We focus on each question in turn considering the evidence and argument presented by the parties.

- ***Do PacifiCorp's Circumstances Establish the Need for a PCAM?***

68 The Company and Staff offer evidence that variability in the Company's hydropower generation and other costs result in annual net-power cost variability in the range of $26 million (Staff) to $48 million (Company).[41] Staff notes that its $26 million estimate constitutes 30 percent of the average annual net-power costs allocated to Washington under the WCA and that $16 million (*i.e.,* approximately 60 percent) of this swing is in the direction of higher costs. Staff asserts that this variability in costs is driven by variability in hydro-generation as well as in wholesale power prices and fuel prices over which the Company has no, or limited control.[42] However, Staff cautions that its measurement of the variability in power costs reflects circumstances of the extremes in poor or beneficial water and that the probability of these circumstances occurring is low.[43] Staff concludes that the Company faces variability in net power costs sufficient to justify approval of a PCAM.[44]

69 While ICNU asserts that variability in wholesale power and fuel prices do not justify a PCAM, it concedes that the Company does face variability in hydropower generation.[45] In ICNU's view it would be sufficient to limit the operation of a PCAM to respond to power cost swings caused by hydro-generation variability.

70 Public Counsel contends the Company relies on hydropower for only 17.9 percent of the generation necessary to serve WCA loads and that on a system-wide basis it uses

[41] Staff Brief ¶ 49; Exhibit 261 at 33:12-34:16 (Buckley)
[42] Exhibit 261 at 32:16-33:10 (Buckley)
[43] Exhibit 261 at 35:1-8.
[44] Staff Brief ¶ 50; Exhibit 261 at 34:18-23
[45] ICNU Brief ¶¶ 41 and 47; Exhibit 161 at 69:10-16

only 5 to 8 percent hydropower. Considering these figures and the proposition that a PCAM is a departure from normal regulation that must be justified by need, Public Counsel argues that a PCAM is not justified in PacifiCorp's circumstances.[46] Public Counsel asserts that PacifiCorp is already compensated for variability in net power costs through normalization and opportunities to seek power-cost deferrals.

71 We find the analyses by Staff and PacifiCorp demonstrate the Company is subject to significant power cost variability. We find the amount of potential variability sufficient to warrant consideration of a PCAM as a means to accommodate this variability in ratemaking.

- ***Is it Practical and Appropriate to Approve a PCAM in this Case?***

72 The Company and Staff contend that it is both practical and appropriate to implement a PCAM in this proceeding.[47] The Company, on brief, sets out its requirements for acceptance of the Staff's modifications to its initial proposal.[48] For its part, Staff argues that the PCAM issues are ripe for resolution in this case and that the Commission should reject Public Counsel's and ICNU's recommendations to delay consideration of a PCAM to a later date.[49]

73 ICNU and Public Counsel both object to the use of computer estimated costs to true-up normalized base power costs that are also derived from the GRID model.[50] Public Counsel observes that the Commission has never approved a power cost adjustment mechanism "based on use of a computer model to derive actual power costs."[51] Public Counsel contends that the combination of a "new and untried" interstate cost allocation model with estimation of actual costs based on a computer model is ample reason to conclude that implementation of a PCAM in this case would be premature.[52] Public Counsel wants to see a means developed to determine actual costs before any PCAM is approved.

74 ICNU objects to use of computer-generated costs, characterizing them as "fake numbers." According to ICNU, this process is susceptible to manipulation, though it offers no concrete examples. ICNU contends that "ratepayers should only be charged normalized projected costs reviewed in a rate proceeding or verifiable actual costs subject to an appropriate review." ICNU says it would be inappropriate "to charge

---

[46] Public Counsel Brief ¶ 6-17
[47] Staff Initial Brief ¶¶ 98-100.
[48] PacifiCorp Initial Brief ¶ 24.
[49] Staff Initial Brief ¶¶ 111-113.
[50] GRID is a propriety computer model on which PacifiCorp relies to determine future power costs.
[51] Public Counsel Brief ¶ 18.
[52] *Id*. ¶ 23.

ratepayers a combination of some actual and some projected data plugged into an untested model."[53]

75 Both the Company and Staff contend ICNU and Public Counsel exaggerate use of "pseudo-actual" costs (*i.e.,* costs derived from a model rather than a record of actual costs) to true-up normalized base power costs. They observe that a "re-dispatch" calculation is necessary since the WCA method does not reflect the Company's actual system-integrated dispatch of its generation and transmission. PacifiCorp and Staff also contend that the inputs to the re-dispatch model will include a substantial number of actual costs and resources and should not preclude the Commission from approving a PCAM in this case.[54] Staff contends that its recommendation to increase the deadband from $3 million to $4 million and to require the Company to "continually improve its ability to develop and provide actual data" addresses any concerns it has about imprecision in pseudo-actual costs. In addition, Staff contends that a PCAM offers the benefit of reducing controversy in normalizing power costs in the context of a general rate case while sending more accurate price signals to customers. In short, Staff argues that these benefits outweigh any problems that the estimation of actual costs might pose.[55]

76 Base power costs are a statistical estimation of what level of costs is expected under normal conditions. Because this is an estimate, it is not expected to match the actual costs incurred in any given year. The core idea of a power cost adjustment mechanism is to true-up these estimated costs with actual costs that are the measured and documented costs that did occur in a given year.

77 Our concern is that the computer-generated, pseudo-actual costs will themselves be only estimates including some statistical (*i.e.*, modeling) variability (*i.e.*, error). The Company and Staff contend that actual data, rather than assumptions, will be used in the computer model. Presumably that will reduce the modeling error and produce a more precise result. Truing-up one estimate with another more precise estimate *may* be justified, but the risk is that neither will be accurate and using two inaccurate, even if precise, estimates of cost to set cost-based rates could lead us to depart farther and farther from actual costs. A key problem with this approach is that we would never know.

78 In this record, ICNU and Public Counsel have presented no concrete evidence of the risk, only abstract fears. On the other hand, the Company and Staff have offered mainly assurances without any actual demonstration of the reliability of their computer-driven method. Staff's argument that a PCAM offers benefits that outweigh the risks of using pseudo-actual costs (*i.e.,* less controversy in setting base

---

[53] ICNU Brief ¶¶ 43-45.
[54] *Id.* ¶¶ 101-105; PacifiCorp Brief ¶¶ 26-28.
[55] Staff Initial Brief ¶¶ 106-107.

power costs and better price signals) is not very persuasive. Avista and PSE have power cost adjustment mechanisms, but the Commission has seen little damping of enthusiasm for disputes about their normalized costs. Under these circumstances it does not appear to us that the proposed PCAM would be a substantial improvement over traditional normalized-cost rate-setting, at least until a more thorough and detailed explanation is made of how the pseudo-actual costs will more accurately and reliably represent actual costs than do the normalized base costs.

79 Although we find the record does not support the Company's proposed PCAM, we recognize that PacifiCorp may wish to petition for approval of a revised mechanism that addresses the problems we identify here. It is useful, therefore, to analyze the remaining three questions we identified at the outset to provide additional guidance.

- ***Are the Designs Proposed for the PCAM Appropriate for PacifiCorp?***

80 The Company and the Staff agree on most of the design elements for a PCAM, albeit with some conditions required by the Company for its acceptance of Staff's recommendations concerning the $4 million deadband, $10 million threshold for the outside sharing band, and the removal of fixed costs for new resources.

81 For its part, Staff says its PCAM design is proper, is based on PacifiCorp's "specific circumstances," balances risks and benefits as much as possible, and is synchronized with Staff's water-adjustment 5.6.[56] According to Staff, its proposed PCAM design nonetheless "shifts significant risk to ratepayers."

82 The Company and Staff agree that the variable cost of new resources less than 50 MW and with a term less than 2-years should be included in the PCAM, but disagree on whether fixed costs should be included. The Company argues that including these fixed costs is necessary to accommodate its need to acquire renewable resources in the future to comply with Washington's Renewable Portfolio Standard.[57] PacifiCorp agrees to exclude these fixed costs from the PCAM, however, if the Commission authorizes it to file for approval of PCORC mechanism that accommodates an annual adjustment.[58] In general, we find it appropriate to include in the PCAM the variable costs of smaller, short-term resource additions, but to exclude the fixed costs. There has never been any barrier to the Company filing for approval of a PCORC mechanism. Indeed, it could have done so in this docket, but did not raise the idea until late in the proceeding. Even then, the Company did not make a specific, detailed proposal. The Commission will certainly give any such proposal fair consideration if and when filed.

---

[56] Staff Brief ¶¶ 93-96, 110
[57] RCW 19.285.
[58] *Id*. ¶ 25

83 All the PCAM designs included in this record include the common elements of a symmetrical deadband and symmetrical inner and outer sharing bands. The designs are consistent in these respects with the approaches used in the PSE and Avista mechanisms to balance risks and benefits between customers and shareholders while also including encouragement for the utility to manage its costs. That consistency ignores two important points. First, each company's individual circumstances must be considered and must inform the development of a PCAM. This may mean that certain aspects of a PCAM approved for one utility may need to be modified or not used for a different utility.

84 Second, it is not sufficient justification for approval of a PCAM today to simply be consistent with PCAMs approved earlier, under markedly different market conditions and circumstances of financial distress for the utilities involved. Under present circumstances we can, and should make efforts to refine the design and operation of any PCAM.

85 This case illuminates a point not analyzed in our prior consideration of PCAMs--the distribution of net power costs may not be symmetrical, but skewed and not statistically normal. For example, in this record the distribution of net power costs is skewed toward higher costs, in part because poor hydropower is correlated with higher wholesale power costs and higher fuel costs. Staff finds that 60 percent of the variability in the Company's power costs is on the "high side." This means that any symmetrical PCAM design will shift some level of risk to ratepayers, because the probabilistic benefit ratepayers receive from good water conditions does not equal the probabilistic risk customers will incur from poor hydrologic conditions.

86 An optimally designed PCAM would recognize the inequality between upside and downside risk in its design of deadbands and sharing bands. For example, to equally balance risk with benefit, the deadband and sharing bands should be set at lower levels on the "lower cost" side of base costs to increase the expected value of customer benefits enough to balance the expected value of customer risks on the "high side" of base costs. The parties in this proceeding have not proposed such a design.

87 All three PCAM designs present in this case entail a shift in risk that arguably needs to be accompanied by a modification to the Company's return to compensate for that shift. In the alternative, a PCAM design that recognizes the asymmetry in risk would not produce a risk-shift and might not require any adjustment to the Company's allowed return. In light of the record in this proceeding, it is evident that recognition of potential asymmetry in risk in any PCAM design represents a significant refinement that must be considered as we review PCAMs in the future.

- ***Are Adjustments to the Water-Record Used for Normalization Necessary?***

88 A properly designed PCAM should incorporate not only the deadband and sharing bands, but also recognize the way normalization is used to set the base power costs around which the PCAM operates. If the Company and its customers will share the costs and benefits of unusual power cost extremes, there is no need to include those extreme circumstances in the calculation of normalized power costs, particularly if they are controversial. The Staff and the Company seem to agree that using a narrower range of hydropower conditions for normalization is appropriate in the context of a PCAM.[59] They differ on the question of how the extremes should be identified and filtered out. Staff and ICNU agree on the mechanics of filtering water years, but only ICNU argues in favor of this kind of adjustment with or without a PCAM.

89 We agree with Staff and PacifiCorp that water filtering is appropriate in the context of a PCAM, but not appropriate if there is no PCAM in place. ICNU argues that current rates are based on such an adjustment and that if such an adjustment is not made, the Company will be able to benefit from good water years and seek emergency deferrals in bad water years.

90 The theory ICNU propounds is flawed on two counts. First, the use of filtered water-years in the settlement of a prior PacifiCorp case is not precedent for resolution of the water-year issue in this case—particularly given the Commission's long-standing practice of using 40-year rolling averages for water-year records.

91 Second, the proposition that utilities will always seek deferral of, and secure cost-recovery for excess power costs incurred during poor water years is problematic at best. Utilities have sometimes taken this course in the recent past, but not all of those requests resulted in approved deferrals and not all have lead to cost-recovery—certainly not 100 percent cost-recovery.

92 Thus, we reject ICNU's recommendation to use filtered water years absent a PCAM. We consider next the question of how water years should be filtered.

93 Staff contends that if a water-year adjustment is made it should be based on plus or minus one standard deviation from average water years rather than the rank-order

[59] PacifiCorp argues that statistical filtering to remove extreme s is not necessary because the 40-year average already limits the amount of hydrological data used in order to "filter-out" the extreme low water years of the early 1930s.[59] However, it agrees to accept a water-year adjustment if a PCAM is approved and a statistically sound filtering method is used.

approach proposed by the Company.[60] Staff argues that the Company's proposal "fails to recognize that it is balancing the variability in the amount of generation available that is important, not balancing the actual number of water years that are wet or dry."[61]

94 PacifiCorp argues that the Staff proposal has the effect of biasing the water-year record from a "normal" probability distribution to one that contains a higher proportion of good water years than poor water years. The Company proposes to adjust water-years using a rank-order statistical technique that removes all water years, both high and low, that fall outside the 67th percentile of the water-year probability distribution.

95 We are puzzled by Staff's objection to the Company's proposed water-year method.[62] Staff seems to miss the point that the Company's method is proper not because it seeks to "balance the number of water years that are wet or dry," but because it better reflects the skewed nature of the distribution of GRID power costs. As discussed in more detail below, we are persuaded that the Company's statistical theory is correct, but we note that there is no firm record on which we could accept the Company's adjustment were there a need to do so in this proceeding.

96 With respect to the fundamental question whether water-years ought to be filtered or not, we observe that the adjustments proposed by ICNU and Staff do not statistically filter the water-year data. Instead, they filter the distribution of GRID-estimated power costs that result, in part, from the water-year record.

97 To explain this, we must enter the realm of statistics. Based on its experience in prior cases the Commission knows that the water-year record itself is normally distributed. The Company asserts as much in this case. That does not mean, however, that the results of the GRID Model are normally distributed. Those results are the product of many factors—not just water variation. Some of those factors—like the cost of power in the market and natural gas costs—are likely themselves to be correlated with water variation.

98 Consequently, the distribution of GRID-produced net power costs is likely to be abnormal—skewed in one direction or the other away from the mean.[63] In a normal probability distribution the arithmetic mean and the median, both measures of central

---

[60] ICNU advocates this same approach.
[61] Staff Initial Brief ¶ 131-136
[62] *See* Staff's reasoning at Staff Brief ¶ 136. Staff's point eludes us. Whether a year is wet or dry contributes importantly to the amount of generation available.
[63] In fact, Advisory Staff have examined the 40 water-year simulations documented in Exhibits 168 and 264. The hydropower generation is indeed symmetrically (normally) distributed about the arithmetic mean. However, the total GRID power costs are skewed in the positive direction (*i.e.*, high values depart farther from the mean than do low values). The mean of the GRID power costs is slightly higher than the median.

tendency, should be very close to the same or identical. In addition, the percentile ranks should be very close to the standard deviation measurements of variation in the probability distribution. For example, two-thirds of the cases should fall within plus or minus one standard deviation of the mean and these cases should also fall within the 67th percentile rank of the distribution.

99 The fact that the methods advocated by Staff and the Company produce different results demonstrates persuasively that the GRID-generated estimates of net power costs are not normally distributed—even if the underlying distribution of water-years is normally distributed. The objective of water-year filtering should be to capture the combined effect of variation in water as well as other factors that affect power costs that may be related to water variation.

100 Based on these statistical points, the Company's theory prevails. The method of analysis it proposes would be the appropriate one to use when faced with a probability distribution that is not symmetrical. To do otherwise filters out too many of the high estimates and produces an average estimate of net power costs that is biased in the direction of above-average water conditions. Unfortunately, the Company does not document its calculation of a water-year adjustment, so we are left with only its theoretical argument without any detail for us to confirm how it applied that theory.

101 We find that filtering water-years is appropriate in the context of a PCAM, but that such filtering must reflect whether the distribution of variability in power costs is symmetrical or skewed as well as how the deadband and sharing bands are designed to reflect asymmetry in the risks and benefits that may accrue to both customers and the Company.

- ***Are Risk-Adjustments to Cost of Capital Necessary?***

102 Staff argues that any PCAM approved for PacifiCorp must include a cost-of-capital adjustment because the Commission has established a "standard" that requires a cost of capital offset.[64] According to Staff "it is obvious that a PCAM shifts risk from shareholders to ratepayers" and the only challenge is to measure how much the offset should be. ICNU and Public Counsel agree.

103 The assertion made by Staff, ICNU and Public Counsel that the Commission has set a standard or has a policy that any power cost adjustment must be accompanied by a cost-of-capital risk-adjustment is erroneous. The need for, and nature of a risk-adjustment is driven by the design of a PCAM—the way it apportions risks and benefits--not simply by its existence. We emphasize that there are several different

---

[64] Staff Brief ¶¶ 67-70

ways to adjust for risk. We do not, nor has the Commission ever required an explicit adjustment to the cost of capital as the sole means to adjust for risk.

104 It is important to observe that both Staff and ICNU evaluate risk-shift as though it goes in one direction only: from the Company to the customers. Both analyses thus fail to recognize that the symmetrical design of the PCAM means that the Company also incurs new risk: the risk that it will not retain 100 percent of the benefit from power costs being lower than what is included in rates as it might in the absence of an adjustment mechanism. Using the Staff's term, the PCAM means that under good power cost conditions the Company is now required to "chip in" savings to customers that it would have otherwise retained. This oversight is a flaw fatal to both the ICNU and Staff proposals to adjust the Company's authorized return.

105 Staff presents a detailed analysis that purports to capture the shift in risk from shareholders to ratepayers based on measuring the amount by which a PCAM insulates the Company from loss of operating margin (*i.e.*, pre-tax interest coverage). In a nutshell, Staff compares the status quo with the way its PCAM apportions adverse power costs associated with an absolute level of risk. Staff argues the Company could incur $13 million in adverse power costs under current ratemaking. Staff calculates that, under its proposed PCAM the Company could incur as much as $25 million in adverse power costs before reaching the same level of financial distress, based on a pre-tax interest coverage ratio of 2.5. Staff argues that this increase is "proof positive" that substantial risk is removed from shareholders and shifted to ratepayers.[65]

106 Based on this asserted substantial shift in risk Staff calculates a very precise estimate of what it contends is the necessary adjustment: a reduction of the equity component of the capital structure from 46 to 42 percent.[66] The consequence of this change to a hypothetical capital structure is to reduce the Company's overall rate of return (*i.e.*, weighted cost of capital) from 8.06 percent to 7.90 percent.[67]

107 We find inherently suspect assertions that such precise adjustments to cost of capital can or should be made. We have seen many times that cost-of-capital measures are not precise and, indeed, we often look at a range of reasonable outcomes and strike a

---

[65] *Id*. ¶¶ 75-80.
[66] *Id* ¶ 80. The Company opposes Staff's adjustment to the capital structure because it is based on a faulty metric no longer used by the debt rating agencies (*i.e.*, pre-tax interest coverage), because Staff's calculations contain alleged errors, and because Staff's adjustment to the equity component of the capital structure violates the Company's commitment in the MEHC acquisition to maintain a 48 percent equity component. PacifiCorp Initial Brief ¶¶ 53 -60.
[67] In general, if it is necessary to adjust overall return to compensate for the allocation of risk, we think it is more appropriate to make a direct adjustment to return on equity by, for example, moving to the low end of a range of reasonable returns, than to use a hypothetical capital structure to accomplish a mathematically similar or even identical result.

balance among a host of competing considerations. Staff's analysis is incomplete because it does not include consideration of the cost savings that would be apportioned to ratepayers if power costs are lower than determined in rates. That is, Staff's analysis does not reflect that the variability of power costs follows a probability distribution that extends both above and below normalized power costs. Introduction of a PCAM may change the allocation of risks and benefits produced by this variability, but a comprehensive analysis of risks and benefits must consider the expected variability in power costs both above and below the normalized level.

108 ICNU argues that if its proposed hydro-hedge PCAM is adopted, a 30 basis point adjustment is necessary to the Company's ROE – producing an overall return of 7.92 percent. ICNU bases this adjustment on the difference in yield between utility bonds rated single "A" and "BBB," but ICNU does not directly tie such a change in bond rating to PacifiCorp's circumstances or to the design of ICNU's or the Company's PCAM. There is nothing in ICNU's presentation that persuades us that the difference between single "A" and "BBB" yields is relevant to PacifiCorp's unique circumstances or the details of the PCAMs under consideration in this record. We find this proposal disconnected from the real circumstances of this case.

109 In sum, both Staff's and ICNU's analyses are incomplete and inaccurate because they fail to consider the benefit to the ratepayer and increased risk to PacifiCorp that the utility will not retain all power cost savings if costs are lower than the deadband. In addition, the ICNU analysis fails to demonstrate relevance to PacifiCorp's circumstances.

110 On the other hand, Staff, ICNU and Public Counsel are correct to argue that PacifiCorp is wrong in its assertion that the issue of risk-adjustment was subsumed in the Company's most recent prior rate case or is made irrelevant by the existence of PSE and Avista's cost adjustment mechanisms. The issue of risk-adjustment is relevant and important in the evaluation of any PCAM. The evaluation of risk, however, must be balanced and may result in a determination that a given PCAM is so well designed that no adjustment is necessary to ensure fairness between a utility and its ratepayers. If an adjustment is found to be necessary, the Commission has several options available including an overt adjustment to authorized return if adequately supported.

- ***Summary of PCAM Discussion***

111 In summary, any subsequent filing seeking a PCAM and/or a PCORC must:

- Demonstrate the process, accounting, and reliability of the computer-generated "actual costs" for use in the annual PCAM true-up.

- Refine the PCAM design to reflect asymmetry of power cost distribution.
- Include in the case of a PCORC proposal the condition that if rates are so adjusted, a general rate case must be filed within a certain term.
- Direct that any water-year adjustment for power cost normalization must be consistent with the way the PCAM design reflects the asymmetric power cost distribution.

c. Net Power Costs

112 ICNU and Public Counsel jointly sponsor Mr. Falkenberg who recommends seven adjustments to the Company's GRID Model-derived net power costs for the west control area and, by extension, the WCA net power costs allocated to Washington.[68] In total, Mr. Falkenberg recommends reducing the Company's net power costs allocated to Washington by $9.87 million. Table 3 presents the proposed adjustments.

TABLE 3
ICNU/Public Counsel Recommended Adjustments to GRID-Modeled WCA Net Power Costs (Washington Share)

Adjustment	NOI Effect [69]	ICNU Estimated Revenue Requirement [70]
Remove Short-Term firm	$5,158,814	-$7,936,636
SMUD[71] Contract	$1,800,709	-$2,770,322
Centralia Risk Sharing	$1,160,206	-$1,784,932
GP Camus	$20,119	-$30,952
Hydro Water Year Modeling	$1,019,957	-$1,569,165
Ramping[72]	$168,282	-$258,895
Regulating Margin	$123,837	-$190,518
Line Losses	$413,811	-$637,000
Total	**$9,865,735**	**-$13,904,420**

113 For the reasons discussed below, we reject all of these proposed adjustments, except the ramping adjustment and line loss adjustment.

---

[68] Public Counsel's support for these adjustments is not entirely clear. Public Counsel expressly adopts ICNU's initial brief on the WCA interjurisdictional cost allocation issue, but says nothing about power costs.
[69] ICNU Response to Bench Request No. 2.
[70] ICNU Initial Brief at 5.
[71] Sacramento Municipal Utility District.
[72] ICNU uses the more colorful and somewhat value laden term "phantom outages" to identify this adjustment.

i. Short Term Firm

114 ICNU contends that the GRID model improperly accounts for PacifiCorp's short-term firm transactions because the data includes only known transactions at the time the case was filed and this set of transactions includes a large volume of below-market sales by PacifiCorp. Thus, according to ICNU, the GRID model overestimates net power costs because it underestimates the revenue the Company can secure through more profitable short-term transactions. In addition, ICNU argues that the Company has not demonstrated that entering into these firm transactions ahead of time (*i.e.*, before balancing is necessary in real-time) is a prudent strategy that produces benefits for Washington customers commensurate with their cost. ICNU recommends removing all short-term firm transactions input into the model and relying exclusively on model simulations of short-term balancing transactions.[73] According to ICNU, this is the way non-firm balancing transactions are already accounted for in the GRID model.[74]

115 PacifiCorp opposes this adjustment. The Company argues that these transactions are necessary for it to balance its control area loads. According to PacifiCorp, the GRID model does not underestimate the volume of these transactions because simulation models do not capture all the variations in loads and resources that require balancing in real-time.

116 Staff also opposes this adjustment. Staff notes that these transactions will fluctuate over time and the Commission may wish to have the Company update these inputs and rerun the power cost model, or allow them to be accounted for in a PCAM. According to Staff, these transactions are necessary and should not be removed from the model such that all balancing is priced as non-firm, simulated transactions.[75]

117 Utilities with hydropower resources need to make short-term transactions to balance the output of their generation with variations in their load. Utilities have a variety of options for how they accomplish this necessary function. They can make all of their transactions in real-time and incur/accept whatever price the market offers. Alternatively, they can make firm transactions ahead of time based on their forecasts regarding load and generation. The latter is a kind of "hedge" against market-risk, but it exposes the utility to the risk of error in its forecasts of loads and generation. PacifiCorp appears to be following a strategy that uses both of these options – it makes some transactions ahead of time (firm) and others in real-time (non-firm). There is no persuasive evidence in this record that PacifiCorp's strategy is imprudent.

---

[73] Exhibit 161 at 29-32 (Falkenberg).
[74] ICNU Brief ¶¶ 60-64.
[75] Staff Brief ¶¶ 137-138.

118 Accepting ICNU's proposal to remove the short-term firm transactions is tantamount to saying that PacifiCorp should balance all of its loads in real-time. We find no persuasive evidence in this record that supports substituting this strategy for the one the Company actually uses. Nor do we find persuasive evidence showing imprudence or that these transactions are not used and useful. We reject ICNU's recommendation to remove the short-term transactions modeled in GRID for purposes of this case.

ii. SMUD Contract

119 ICNU recommends that a long-term contract PacifiCorp entered into 20 years ago to sell power to the Sacramento Municipal Utility District be removed from the GRID model because it "is imprudent" and ratepayers never received any benefit from the bargain struck in 1987.[76] ICNU asserts that the contract price, $16.85 per MWh, was "below market" at the time the contract was formed and that a $94 million dollar lump-sum payment SMUD made to the Company was "retained and not used to benefit ratepayers."[77] ICNU contends that the $37/MWh PacifiCorp imputes for this contract in the GRID model is below market today and is based on a 20-year Southern California Edison (SCE) contract sale that has now expired. According to ICNU, the imputed value is not appropriate because the SCE contract was shorter and therefore less risky than the 30-year SMUD contract and because the SCE contract no longer exists. ICNU's adjustment would remove $1.8 million (NOI) from the Company's net power costs allocated to Washington.[78]

120 PacifiCorp concedes that the contract negotiated in 1987 included a rate that was below the then-prevailing market and a payment of $94 million.[79] The Company describes the details of the arrangement which included a settlement with BPA for rights to federal power in lieu of power from an unfinished nuclear plant, the Company's sale of the rights to BPA power to SMUD and the subsequent repurchase of those rights in return for the below-market power contract and the lump-sum payment.[80] The Company points out that the $37/MWh imputed value has been included in its last two rate filings and has not been criticized by Staff or any other party.[81] According to PacifiCorp, ICNU's adjustment would be equivalent to imputing today's market price for an old contract. It argues that approach "is an inappropriate and unsupported remedy for evaluating a contract signed over twenty years ago."[82]

---

[76] ICNU Brief ¶¶ 65-66
[77] ICNU Initial Brief ¶ 66.
[78] *Id.* ¶¶ 67-68.
[79] PacifiCorp Initial Brief ¶ 74.
[80] Exhibit 88 at 31:1 to 33:1 (Widmer Rebuttal).
[81] PacifiCorp Initial Brief ¶ 75.
[82] *Id.*

121 Staff also opposes ICNU's proposal to remove the SMUD contract. Staff argues that the fact the contract is below-market today is not relevant to whether it was prudent 20 years ago. According to Staff, ICNU has provided no proof that the contract was imprudent at the time of its inception. Staff also argues that ICNU has provided no proof that the SMUD contract is not relevant to the WCA. Staff testifies that the $37/MWh imputed sales price is a "reasonable and appropriate response" to the concerns raised by ICNU.[83]

122 While ICNU's representation that the SMUD contract was below market when signed and involved a sum of cash that the Company "retained" could be troubling, it is obvious that the complex circumstances of this transaction go well beyond the ICNU's simplistic characterization. This is a matter concerning a contract entered into two decades ago that neither Staff nor any other party has found worthy of attention in the prior rate proceedings in Washington. Principles of fairness suggest that a party aware of facts that raise questions of prudence should raise the issue sooner rather than later when there is an opportunity to do so. While the issue of prudence may be challenged 20 years after the event in question, a substantial showing is required to meet the challenger's burden of going forward.[84]

123 Even if the contract were found imprudent based on evidence concerning the Company's decisions 20 years ago in the context of then-extant circumstances, ICNU's proposed remedy is inappropriate. ICNU's remedy would remove the contract cost and revenues from net power costs. The consequence is equivalent to imputing a contract price at *today's* market rate, not the rate prevailing in 1987. PacifiCorp's use of a contemporaneous contract, even one arguably less risky,[85] is appropriate and adjusts for the below market price in the SMUD contract. ICNU's argument that the expired SCE contract is no longer a valid benchmark is not persuasive because the relevance of the SCE contract is that it measured the value in 1987, not whether it continues in force today.

124 The record does not support a determination of imprudence with respect to the SMUD contract, nor does it support ICNU's recommendation in any other way. We reject ICNU's proposed adjustment.

---

[83] Staff Initial Brief ¶¶ 139-140.
[84] The Company bears the ultimate burden of proof on the issue of prudence, but a party challenging prudence must offer evidence that substantiates the basis of its challenge. ICNU has failed to present such evidence in this case.
[85] We note that there is no evidence showing the comparative risk. Even if we accept ICNU's speculation that a 20 year contract entered into in 1987 would include a lower, risk-adjusted price relative to a 30 year contract entered into at the same time, we have nothing to tell us by how much. The difference could be trivial, and even could be zero.

iii. Centralia Risk Sharing

125 ICNU contends PacifiCorp should be required to absorb a portion of the higher power costs incurred to replace the output of the Centralia generating unit, the sale of which the Commission approved in March 2000 in a decision involving PacifiCorp, Avista and PSE, all former joint owners of the plant.[86] ICNU's proposal is based on Mr. Falkenberg's incorrect reading of the Commission's Centralia Order.[87] Contrary to what Mr. Falkenberg testifies and ICNU contends, the Commission's discussion of risk sharing in the Centralia Order was focused on the proper apportioning of benefits from the sale in light of risks associated with the Company's ownership in the plant – not the going forward risk of replacement power.[88] ICNU takes out of context the phrase: "both ratepayers and shareholders have and will incur risks and burdens." ICNU's argument for the adjustment at issue here depends very heavily, if not exclusively on this selective reference to the Centralia Order.

126 Subsequent discussion in the Centralia Order makes clear that ICNU's reading is mistaken. In response to a proposal by Public Counsel that the utilities selling their shares in Centralia be held responsible for future power costs, the Commission stated the following:

> In paragraphs 44-46, we note that future power costs may prove to be higher or lower than Centralia's cost. To place the utilities at risk if they turn out to be higher, without compensation should they turn out to be lower, establishes an unjustified asymmetry of risks and benefits between ratepayers and shareholders. Establishing some form of "balancing account" to establish symmetry would imply that the only important benefits and risks associated with the sale are power costs. We have previously determined that both the shareholders and the ratepayers will see benefits and risks from the sale that go beyond power costs. Consequently, our determination that the proposed sale is consistent with the public interest does not depend on insulating ratepayers from the possibility of future power cost increases. Therefore, we will not require that the Applicants base future power

---

[86] *In the Matter of the Application of Avista Corporation for Authority to Sell Its Interest in the Coal-Fired Centralia Power Plant, et al.*, Dockets UE-991255, UE-991262 and UE-991409, Second Supplemental Order Approving Sale with Conditions (Mar. 6, 2000) ("Centralia Order").
[87] We note that in Mr. Falkenberg's original testimony he developed his 50/50 risk sharing argument based on his misreading the Centralia Order to have allocated the *gain* on sale 50 percent to ratepayers and 50 percent to the Company. After Mr. Wrigley, testifying for PacifiCorp, pointed out on rebuttal that 87.5 percent of the gain was allocated to ratepayers and that the 50/50 sharing involved only the 12.5 percent *appreciation* amount, Mr. Falkenberg filed an erratum substituting the word "appreciation" for the word "gain" but making no change in his theory or recommendation.
[88] Centralia Order at ¶¶ 84-86.

rates on power costs capped by Centralia's power cost as Public Counsel has proposed.[89]

127 This paragraph makes clear that the Commission did not intend that the Company should necessarily bear all or any part of the obligation for increases in the cost of replacement power. In sum, we find no basis for ICNU's proposed adjustment and we reject it.

iv. Georgia Pacific Camas Cogeneration

128 ICNU recommends adjusting net power costs downward by $20, 919 (NOI) to reflect the historical generation purchased from the Georgia Pacific Camas (GP Camas) cogeneration facility. ICNU argues that generation at this facility has declined over the past few years and therefore cost should be based on a trended analysis of this recent history of declining production rather than potential production.[90]

129 PacifiCorp opposes the proposed adjustment on the basis of 2006 generation from the facility of 162,750 MWh, only slightly less than the 164,608 MWh included in GRID for the test year power costs included in the Company's filing.[91]

130 PacifiCorp has demonstrated that, despite past performance, the production under the GP Camas contract during the test-year is very close to what was assumed in the GRID modeling. The only justifications for adjusting this figure would be for a known and measurable change in the rate year, or to better capture variation using a normalization adjustment. ICNU has made neither of these cases. It argues simply that past generation is a better representation of future generation than is actual generation. ICNU does not attempt to show that generation varies in a way that requires normalization.

131 We find no basis for ICNU's proposed adjustment and reject it.

v. Hydro Normalization

132 In our discussion above rejecting a PCAM, we addressed ICNU's argument that it is appropriate to remove "extraordinary" water years from the water record, regardless of whether a PCAM is approved,[92] because the Company will benefit from over-

---

[89] *Id.* at ¶ 118.
[90] ICNU Initial Brief ¶ 81; Exhibit 161 at 40 (Falkenberg).
[91] PacifiCorp Initial Brief ¶ 78.
[92] As we discussed above in the context of the PCAM issue, Staff does not propose that filtered water years should be used absent a PCAM. The Company also does not oppose a water-year adjustment in the context of a PCAM, but objects to Staff's methodology. We have discussed previously the different approaches and provide guidance to the parties if PacifiCorp elects to petition for approval of a PCAM. *See supra* ¶¶ 90-92.

recovery when water is good and seek power cost deferrals when water is poor.[93] We need not repeat our reasoning here.

133 ICNU also argues that Staff's recommendation in UE-032065 supports use of filtered water years in this proceeding and notes the fact that rates are currently set using such a water-year treatment. The use of filtered water-years in current rates results from the Commission's approval of a settlement agreement in Docket UE-032065. Commission approval and adoption of a settlement agreement does not establish precedent for resolution of issues in subsequent proceedings, including the water-year issue in this case. To determine otherwise would be particularly inappropriate given the Commission's long-standing practice of using 40-year rolling averages for water-year records in many contested cases.

134 We find that in the absence of a properly designed PCAM, normalized power costs should include the effects of both unusually high and unusually low hydrologic conditions. Accordingly, we reject ICNU's proposal to filter the available data and reject the resulting adjustment to revenue requirement that ICNU recommends.

vi. Thermal Ramping

135 ICNU objects to a Company adjustment to outage rates for thermal plants used in the GRID model and argues it should be reversed. ICNU argues the Company's departure from its historic practice of using annual averages and its substitution of a 48 month rolling average to measure outages at coal-fired plants produces "phantom outages," is "extremely unusual, contrary to standard industry practice, inconsistent with standard NERC formulae used to compute forced outages."[94] ICNU argues that the Company has not supported its outage assumption by any studies or other factual evidence.

136 PacifiCorp does not dispute that its approach is novel. The Company contends, however, that it is appropriate to change to monthly data because the high degree of variability in the market value of energy during recent periods results in a mismatch in terms of the timing of outages and their resulting costs if annual averages are used. According to the Company "it is a fact" that PacifiCorp's coal-fired plant ramping requirements exceed the outage assumptions in its GRID model. However, the Company does not produce direct evidence that demonstrates this asserted fact. Assertions not backed up by data that can be confirmed are not reliable evidence.

137 We find that PacifiCorp has not carried its burden to show the change in methodology that it proposes in this case is appropriate. Accordingly, we adopt ICNU's ramping adjustment.

---

[93] ICNU Initial Brief ¶ 75-77; Exhibit 161 at 41-47 (Falkenberg)
[94] ICNU Initial Brief ¶ 79.

vii. Regulating Margin

138 ICNU recommends adjusting "Regulating Margin" to 125 MW from the Company's 225 MW to reflect the Company's historical practice and information Mr. Falkenberg received from a discussion with Company operating personnel at a technical conference in 2004.[95] ICNU argues the Company has not proven that its actual operations now require an increase of operating margin to 225 MW.

139 PacifiCorp opposes ICNU's adjustment arguing that the 2004 information conveyed to Mr. Falkenberg is no longer accurate and has been replaced by a study completed in 2005. According to the Company, its modeling input for regulating margin should be based on the most current information. PacifiCorp contends the 2005 study supplies that information.[96]

140 We find the Company has justified its use of a 225 MW regulating margin, having presented results of a recent study of its system and Mr. Widmer's testimony describing its results. ICNU's contention that the Company only uses 125 MW of regulating reserve is based on stale and not particularly reliable information, an informal conversation in November 2004 between Mr. Falkenberg and unidentified PacifiCorp "operating personnel". In short, the Company's claim that it needs 225 MW of regulating reserve is supported by substantial evidence; ICNU's challenge is not.

viii. Line Losses

141 As part of its criticism of the WCA method, ICNU argues Washington customers should only pay for a normalized level of line losses (*i.e.*, the average over the past five fiscal years) of 10.107 percent rather than a test-year figure of 10.95 percent. ICNU argues that load levels are normalized so line losses associated with serving load should similarly be normalized rather than based on a single year's measurement. This reduces the Company's revenue requirement by approximately $.68 million.[97]

142 On rebuttal, PacifiCorp contests this adjustment to its revenue requirement as being an inappropriate departure from use of test-period data. PacifiCorp asserts that loss levels are "a complicated function of many variables and their interactions" and that because these interactions cannot be modeled, it is not appropriate to make an adjustment to the actual test-year data. The Company, however, provides no evidence

[95] *Id.* ¶ 80.
[96] PacifiCorp Brief ¶ 82; Exhibit 88 at 39:1-9 (Widmer Rebuttal).
[97] *Id*. ¶¶ 32-34

to substantiate its assertion. A bare assertion carries little weight and leaves us unpersuaded.

143 ICNU's proposal to adjust line losses using a five-year average rather than a single year reflects a common and persuasive approach for smoothing-out year-to-year variation in a cost that varies with weather and load. ICNU argues correctly that load is normalized in rate-setting. It seems reasonable that line-losses related to serving load should be normalized as well. We accept ICNU's adjustment.

d. Revenue Requirements

144 Table 4 summarizes the impacts of ICNU's and Staff's proposals on the expenses and ratebase for which PacifiCorp seeks recovery. We discuss each of these in turn, below.

TABLE 4
Impact of Staff and ICNU Proposals on Company Rate Base, Revenue Requirement and Net Operating Income

Adjustment:		Rate Base	Revenue Requirement[98]	Net Operating Income
Income Taxes	ICNU	$0	($3,085,312)	$1,914,245
IRS Settlement	Staff	($1,324,386)	($624,759)	$387,624
Working Capital	Staff	($7,719,193)	($1,269,035)	$787,357
MEHC Transition Costs Deferral[99]	ICNU	($11,523,107)	($1,894,398)	$1,175,357
	Staff	(1,045,036)	($926,332)	$574,732
Pension Expense	ICNU	$0	($944,295)	$585,877
Incentive Compensation	ICNU	$0	($2,044,969)	$1,268,777
Health Care	ICNU	$0	($282,089)	$175,019
A&G Rate Cap[100]	ICNU	$0	($278,544)	$172,819

i. Federal Tax Disallowance

---

[98] Conversion factor is .620438 per Staff Initial Brief Appendix A.

[99] PacifiCorp accepted Staff's adjustment in part and agrees to a NOI adjustment of $1,304,872. Thus, these numbers reflect the *difference* between the Staff and ICNU proposals and the amount the Company agrees to accept.

[100/] ICNU advocates an adjustment for the A&G Rate Cap only if the Commission accepts Staff's proposed Pro Forma Wages (Adjustment 9.3) which reflects an increase from the filed case to which PacifiCorp agrees.

145 Mr. Gorman testified for ICNU that the pro forma calculation of income tax expense overestimates the amount of tax that the Company will actually pay because PacifiCorp's income tax payments contribute to a consolidated tax return.[101] ICNU recommends that the Company's allowance for federal income tax recovery in rates be reduced to reflect the deductibility of interest on the debt held by MEHC and used to fund its investment in PacifiCorp. According to ICNU, this would reduce the Company's revenue requirement by $3.0 million ($+1.9 million NOI).

146 Mr. Evans and Dr. Hadaway testify for the Company rebutting ICNU on this matter. Mr. Evans testifies that Mr. Gorman's analysis ignores the "factual setting of Berkshire Hathaway's (Berkshire) consolidated federal tax return." According to Mr. Evans, Berkshire, the ultimate parent of PacifiCorp and the entity that files a consolidated tax return, has no net debt and therefore the debt imputation made by Mr. Gorman makes no sense.[102] He claims that all taxes paid by taxpaying entities contributing to a consolidated return are ultimately paid to the government in an amount equal to what they would have been on a stand-alone basis. According to Mr. Evans, consolidation affects only the timing of tax payments, not the total amount ultimately paid.[103]

147 Mr. Evans contends that Mr. Gorman's adjustment also violates the "matching" and "benefits follow burdens" doctrines of regulation because it only captures benefits from debt without including the associated costs or risks of increased leverage.[104] That is, ICNU's proposed adjustment would allocate to ratepayers the tax value of imputed interest on debt at MEHC even though the MEHC interest costs which produced the benefit are not included in rates.

148 Dr. Hadaway contends the adjustment proposed by Mr. Gorman violates the Commission's decision to reject double-leverage in the 2005 Rate Case. PacifiCorp, on brief, outlines the parallels in Mr. Gorman's analysis to the ICNU approach to double leverage in the acquisition case, Docket UE-051090. Basically, ICNU's approach assumes PacifiCorp's equity is funded in part by MEHC's debt and imputes to PacifiCorp $5.469 million in additional interest associated with the debt. The pertinent language about this approach from the Commission's 2005 Rate Case Order is:

> The ring fencing provisions required by our final order in Docket UE-051090 insulate PacifiCorp and its customers from risks and financial distress at the MEHC level. In addition, conditions affecting the flow of dividends from PacifiCorp to MEHC serve to constrain the ability of

---

[101] Exhibit 181 at 3-10 (Gorman)
[102] Exhibit 21 at 5 (Evans)
[103] *Id.* at 6-10 (Evans)
[104] *Id.* at 10-14 (Evans)

> MEHC to manipulate the capital structure of PacifiCorp. Staff describes the ring fencing provisions as "state of the art."
>
> Nonetheless, after having insulated PacifiCorp and its customers from the risks of leveraged financing at the parent, Staff and Public Counsel seek to secure for customers the cost and tax benefits of that financing. The Company's expert witness argues this may violate the familiar principle in utility law that financial benefits should follow burden of risks. We agree. If the risks and costs of activities at the parent-level are borne exclusively by shareholders-because customers are insulated from them by the ring fence-then it is fair and appropriate for the shareholders, and not the customers, to receive the benefits that result from those activities.[105]

149 Mr. Kermode, for Staff, agrees with PacifiCorp that Mr. Gorman's assertion that the adjustment reflects what taxes will actually be paid by the Company is "simply wrong" because it fails to consider what Berkshire Hathaway's other tax liabilities may be. In this connection, Staff contends allocation of PacifiCorp's share of the ultimate parent's tax liability could result in ratepayers being called on to bear even higher income tax expense than is the case using the stand-alone approach the Commission has historically taken. He also asserts, again in agreement with the Company, that ICNU's adjustment is actually a partial "double-leverage" adjustment and if ICNU wishes to raise the issue of double-leverage in the Company's capital costs it should do so completely.[106]

150 Although there is some facial appeal to the idea that ratepayers should pay no more taxes in rates than the amounts for which the subsidiary company is liable, we find ICNU's approach unsupportable. There are at least two strong arguments developed by both the Company and Staff against adjusting income tax by imputing interest on debt that is not actually in PacifiCorp's capital structure. First, there is the problem that to the extent we wish to examine the question as one involving the advantages of consolidated income tax filings, the consolidated tax return we must concern ourselves with is that of Berkshire Hathaway, not MEHC.[107] ICNU's nominal rationale for focusing on MEHC, one of the 500 affiliated companies included in Berkshire Hathaway's corporate family, is that it is too complicated to look at the full picture. Given that the context for ICNU's recommendation is the interrelationship among affiliate financial data that informs the consolidated tax return, it is not credible to stop at the level of MEHC and disregard other corporate affiliates simply because ICNU finds it too difficult to examine.

---

[105] 2005 Rate Case Order ¶¶ 284-85.
[106] Exhibit 314 at 5-7 (Kermode).
[107] We do not have Berkshire Hathaway's tax return in the record, so it is impossible for us to know how MEHC's and PacifiCorp's tax liabilities are ultimately reflected in taxes paid.

151 The second key problem is the care taken to separate the financial circumstances of PacifiCorp from the other affiliates, including MEHC, through "state of the art" ring fencing approved by the Commission in the acquisition proceeding. In this context, it would be very difficult to justify joining the financial circumstances of MEHC and PacifiCorp by imputing MEHC debt costs into PacifiCorp's capital structure. As the Company and Staff argue, this smacks of the very sort of thing we squarely rejected in the Company's most recent prior general rate proceeding when presented as a "double leverage" adjustment.

152 We note finally that what ICNU proposes here is tantamount to asking for a tax true-up. True-up mechanisms, a form of single issue ratemaking, are not generally favored in utility ratemaking.

153 We reject ICNU's proposed adjustment to reduce income tax as unsupportable.

ii. IRS Settlement

154 Staff contests through Mr. Kermode's testimony the Company-proposed tax adjustment to reflect amortization of a settlement with the IRS (Adjustment 7.6). This adjustment relates to a Company settlement with the IRS, in which PacifiCorp agreed to pay an additional $64,217,849 in federal income taxes for eight historic tax years: 1991 through 1998. The Company computes Washington's allocated share as $5,797,266, but reduces this amount by 50 percent, or $2,898,633, nominally to reflect what was agreed for purposes of settling the 2003 rate case. This amount is further reduced to reflect an unamortized balance of $1,159,454 (rate base) and a test year expense amount of $579,726.

155 Mr. Kermode testified that the Commission should reject the Company's Adjustment 7.6 in its entirety for four reasons:[108]

- The income taxes the Company is requesting to recover are costs related to prior periods. Consequently, the Company's adjustment constitutes retroactive ratemaking.

- The Company is in essence requesting that its income tax expense be "trued-up" for the IRS audited years, despite the fact that ratemaking methodology does not generally allow true-ups for prior periods.

- The Company's adjustment fails to reduce the proposed adjustment by the items that are normalized for rate making purposes.

---

[108] Exhibit 311 at 9-23 (Kermode).

- The Company's adjustment is inaccurate because it fails to include the additional income that created the additional income tax.

156 On rebuttal the Company accepted part of Staff's adjustment. According to Mr. Wrigley's table of partially accepted adjustments (Exhibit No. 136 at 5), the Company accepts a revenue requirement impact of ($182,661). Mr. Wrigley briefly describes that the Company accepts removal of the "normalized" items from its adjustment 7.6. However, he does not address the difference between his number and Staff's adjustment and does not describe why he objects to the remainder of Staff's adjustment.[109]

157 All four of Staff's reasons for rejecting Adjustment 7.6 are sound. It is good law, good policy and good regulatory practice to not allow recovery of costs incurred but not recovered in rates during periods before the test period. Ironically, what PacifiCorp urges here is similar to what ICNU advocates as discussed above—a tax true-up. Such true-ups, essentially single issue ratemaking, are not favored generally and should not be allowed here.

iii. Working Capital

158 The Company, relying on its 2003 lead-lag study to determine cash working capital and also accounting for prepayments, fuel stock, and materials and supplies, would include in working capital rate base $16.3 million. Staff, relying on the investor supplied working capital (ISWC) method, proposes that we reject PacifiCorp's adjustment for working capital (*i.e.*, Company adjustment 8.1) and accept Staff adjustments 8.3 (Jim Bridger Mine rate base), 8.14 (remove per books working capital), 8.15 (remove per books current assets),[110] and 8.16 (ISWC per Staff) which together amount to $8,321,198 in rate base to account for investor supplied working capital.

159 PacifiCorp directs its advocacy principally to the question of whether the lead-lag method or the ISWC method is more rigorous, and argues that lead-lag is the generally preferred approach among regulators. Staff focuses its argument on critiquing the Company's lead-lag approach, but does little to persuade us its ISWC analysis yields better results. These methodological arguments are not particularly useful. Both of these approaches to calculate working capital are acceptable, although each has certain deficiencies.

160 There are, in addition, many other approaches taken by regulators to determine the amount of working capital that will be allowed in rate base, if any. Goodman

[109] Exhibit 136 at 18.
[110] *i.e.*, prepayments, fuel stock, and materials and supplies.

discusses "rule-of-thumb formulas" used in some jurisdictions such as the former Federal Power Commission's use of 3 months cash operating expenses plus current materials and supplies.[111] He also discusses the Federal Energy Regulatory Commission's "one-eighth" formula or "45 day" method that divides total operating expenses by eight, the number of 45 day periods in a year assumed for some reason to be 360 days long. Various states also use one or another of these methods, or others.

161 In short, neither the Company's lead-lag approach nor Staff's ISWC approach can be convincingly put forward as "the right way to do this." As should be clear from our 2005 Rate Case Order, however, there is a wrong way to do this and both the Company and Staff have taken that path. At the outset of our discussion of working capital in the 2005 Rate Case Order, we said:

> It is evident from the record that the actual amounts of current assets and cash working capital in dispute are derived by applying the Revised Protocol allocation formula that we have rejected. Consequently, without an acceptable inter-jurisdictional allocation formula, we are not able to resolve the specific adjustments Staff proposes for Washington jurisdictional rate base.

162 In this proceeding we do find an acceptable inter-jurisdictional cost allocation methodology: the WCA method previously discussed. The problem here is that neither the Company nor Staff calculated working capital in a manner consistent with the WCA allocation methodology. Mr. Schooley, for Staff, testified that he performed his ISWC analysis on a total company basis, not a WCA basis, and then applied an allocation factor based on Washington plant relative to total system plant.[112] This, he believes, "captures it to a certain degree."[113]

163 Mr. Wrigley, for PacifiCorp, testified that the Company relied on the same 2003 lead lag study putatively relied on in the 2005 rate proceeding. That study looked at PacifiCorp on a total Company basis and then performed an allocation based on either the revised protocol or modified accord allocation methodology. We expressly rejected the revised protocol in the 2005 Rate Case Order and the modified accord allocation methodology is obsolete.

164 Due to the basic flaws in both parties' working capital analyses and assumptions, as in the prior case, we are unable to resolve the working capital issue here. We accordingly reject PacifiCorp's adjustment for working capital (*i.e.,* Company adjustment 8.1) and Staff adjustment 8.16, the ISWC adjustment. Staff adjustments

---

[111] Goodman, Leonard Saul, The Process of Ratemaking, Vol. 2, pp. 828-838 (Public Utilities Reports, Inc., 1998).
[112] TR. 319:2-5; 323:4-9 (Schooley).
[113] TR 319:12-13 (Schooley).

8.14 and 8.15 are essentially moot, though we reach the same effect by disallowing working capital in rate base. We accept Staff adjustment 8.3, which appears to properly account for the working capital of the Jim Bridger mining operation.

iv. MEHC Transition

165 This issue concerns the treatment of severance payments PacifiCorp made as it trimmed personnel following MEHC's acquisition. The issue is implicated both in the rate case, Docket UE-061546, and the consolidated accounting petition in Docket UE-060817. According to Staff, the amount is significant: $42,883,385 paid to 241 employees by the end of 2006. PacifiCorp proposes to capitalize and amortize these costs over three years.

166 ICNU opposes the accounting petition and in the rate proceeding would remove from rate base 100 percent of the incentive payments.

167 Staff would allow some of these costs, capitalizing $25.9 million into rate base and allowing a three-year amortization.

168 ICNU argues the costs are excessive and characterizes them as "transaction costs" that the Company committed to exclude from PacifiCorp's utility accounts. We reject this characterization. As Staff points out in its reply brief, the "costs of the transaction," as stated in Commitment 16 of the merger settlement, plainly is meant to include the expenses incurred to consummate the transaction, not the expense impact of business decisions the Company made after the deal was consummated.

169 The Company and Staff both argue against ICNU's proposal because it would retain for ratepayers 100 percent of the savings achieved while disallowing 100 percent of the costs incurred to achieve the savings. Staff witness Schooley testified that "this violates the matching principle of accounting." We agree and find that amortization of this type of expense appropriately matches severance costs with the benefits of the avoided future wages.

170 This brings us to the question of whether all or only some part of these costs should be capitalized and put in rate base.

171 Staff would exclude any expense attributable to employees notified of displacement before May 2006, when the Company filed its accounting petition. Staff argues correctly that the Commission's consistent position in this regard is to allow deferral and recovery only for costs incurred during periods that post-date an accounting petition except in extraordinary circumstances beyond the utility's control. Staff's adjustment would reduce the deferral amount by $13.593 million system-wide. We find Staff's adjustment appropriate and will not allow these costs to be included in rate base.

172 PacifiCorp and Staff are also at odds over Staff's proposal to limit in rate base the amount of allowable severance payments to executives so that such payments are proportionate to the severance payments made to non-executives. Staff recommends limiting the recovery of executive severance to the same average level given to non-executives, 88 percent of their pay level. This would reduce the deferral by about $3.4 million system-wide.

173 In further support of its proposal to limit the amount of executive severance payments to be allowed in rate base, Staff states that payments to nine executives account for thirty-six percent of the total payments, an average payment of $1.66 million per executive. This contrasts to the average payment of $117,000 made to 232 non-executives. Staff disputes the idea that the market requires such high levels of severance pay for executives. Staff argues that the Company's testimony that its executives need a long time to find another job belies the Company's rationale that high severance payments are needed to keep PacifiCorp competitive in the executive employment market.

174 The Company states that Staff's argument in this regard is offered without evidentiary support, in contrast to PacifiCorp's proposal that the Company contends is supported by Exhibit 123C, a 2002 study performed by M Benefit Solutions assessing the design of the Company's executive compensation program against the market. Mr. Schooley undertook no such study to evaluate the adequacy of severance arrangements as part of an overall executive compensation package. We do not find this argument persuasive for several reasons. Even if PacifiCorp's payments to executives were consistent with this 5-year old study, that does not mean they were reasonable. In recent years we have witnessed increasing attention to, and criticism of excessive levels of executive compensation and bloated severance packages. This criticism has come in part from prominent members of the business community who have served on corporate boards.[114] Moreover, the appropriate oversight committees of Congress have begun to investigate executive compensation policies and the role executive pay consultants play.[115] Therefore, we are inclined to be wary of studies by consultants

---

[114] Jason Zweig, a writer for MONEY magazine, reporting on Berkshire Hathaway's annual meeting in 2004, quotes Charles Munger, one of the group's top managers, as saying: "I would rather throw a viper down my shirtfront than hire a compensation consultant." This comment came on the heels of Warren Buffett's remarks that: "The typical large company has a compensation committee. "They don't look for Dobermans on that committee, they look for Chihuahuas………Chihuahuas that have been sedated."

[115] *See, e.g.,* Gretchen Morgenson's article entitled *Panel to Look at Conflicts in Consulting* in the May 11, 2007, electronic edition of the Sarasota Herald-Tribune.

that potentially are self-serving and may not provide objective information that is useful to us.[116]

175 Significantly, our record includes evidence that shows a mismatch between the level of payments to executives and the level of benefits derived from those payments. ICNU, on brief, cites some interesting confidential data in the record that Ms. Iverson analyzed to show that 33 percent of the total severance costs are attributable to the top 12 executives. According to Ms. Iverson's analysis, this generates only about 15 percent of the annual savings. In light of this fact it would not be appropriate to allow 100 percent of the executive severance payments in rate base. Ratepayers derive disproportionately low levels of benefit from executive severance payments relative to what they gain from similar payments to non-executive employees. Thus, we find we should disallow a portion of these specific costs as there clearly is a mismatch between benefits and burdens.

176 Staff's recommendation to limit the amount of executive severance payments to an amount equivalent to 88 percent of annual pay, the average amount allowed for non-executives, is reasonable and well grounded in our record. We will require that adjustment to rate base, a reduction of $3.4 million.

177 PacifiCorp does not oppose Staff's recommendation to record the transition costs in Account 182.3 and to begin amortization over a three-year period beginning with the effective date of revised rates determined in this proceeding. PacifiCorp, however, does oppose Staff's recommendation to include the transition costs in rate base as part of a working capital calculation.

178 We will allow PacifiCorp to capitalize and include in rate base $25.9 million, amortized over three years, resulting in an annual amount of $8.6 million. These transition costs should be recorded in Account 182.3. Inasmuch as we have determined a zero working capital allowance, as previously discussed, we need not revisit that issue. The transition costs should be treated as other regulatory assets that are allowed in rate base and on which the Company is authorized to earn a return.

v. Pension Expense

179 ICNU argues PacifiCorp's test period pension expense should be adjusted downward by substituting the average of the 2005 and 2006 fiscal year expense. This would

[116] Kathy M. Kristof of the Los Angeles Times reports that when she asked Mr. Munger about his views on the subject of executive compensation, they had the following exchange:

> Q: How did CEO compensation get so out of whack?
>
> A: Some of the worst sinners are compensation consultants. I have always said that prostitution would be a step up for these people. "Whose bread I eat, whose song I sing."

result in a reduction in the Company's Washington revenue requirement of just under $1 million. ICNU's proposal is based on the fact that PacifiCorp has announced it will make changes to its pension plan effective later this year. Ms. Iverson speculates in her testimony for ICNU that this will reduce costs by some undetermined amount.

180 The Company uses Ms. Iverson's own testimony to show effectively that there is no known and measurable change that would establish a proper basis for a pro forma adjustment to pension expense. Staff, through Mr. Schooley's testimony, makes this same point. PacifiCorp also argues that the Commission found in its 2005 Rate Case Order that the Company's method for calculating FAS 87 pension expense is correct and that this method should continue to be used.[117] PacifiCorp says Ms. Iverson's proposal is at odds with this determination.

181 We reject ICNU's proposal as speculative, since there is no known and measurable change upon which to base an adjustment to PacifiCorp's pension expense.

vi. Incentive Compensation

182 ICNU argues PacifiCorp's incentive payments to executives should be disallowed, as should 50 percent of non-executive incentive payments. This would reduce the Company's Washington revenue requirement by $2 million. ICNU contends PacifiCorp's incentive compensation does not meet the Commission's standard that such expense will be allowed only if total overall compensation is reasonable and the incentives are tied to corporate or business performance, which provides benefits to ratepayers.

183 Mr. Wilson testifies on this issue for PacifiCorp. He provides a fairly detailed discussion of how the Company's compensation system is structured so as to provide competitive total compensation, including a base amount and an incentive payment, for executives and employees who perform at the target level performance objectives for their jobs. Underperformance means lower pay relative to the market rate for a given job as less or no part of the incentive component is earned. Exceptional performance means higher pay than industry average, but such high level performance arguably provides benefits to ratepayers.

184 PacifiCorp argues that Ms. Iverson, ICNU's witness on this issue, is wrong to infer that the use of a balanced scorecard approach to performance evaluation means incentive payments are tied to business and financial performance. This is supported by Mr. Wilson's testimony that the balanced scorecards are not tied to corporate performance, as is evident from a review of the objectives outlined in each

---

[117] PacifiCorp Initial Brief at 53 (citing ¶131 from the 2005 Rate Case Order).

scorecard.[118] The scorecard objectives relate primarily to operational effectiveness, customer satisfaction and safety.

185 It is not apparent that Ms. Iverson did any substantive analysis or evaluation. In 17 lines of testimony she does little more than state ICNU's argument. Considering both that the Company's arguments are persuasive and are supported by the record, and that ICNU offers scant evidence even arguably in support of this proposed adjustment, we reject it.

vii. Health Care

186 ICNU assails PacifiCorp's "gold-plated medical coverage" and criticizes the Company for paying 80 to 90 percent of non-union employees' premiums and 87.5 to 90 percent of union employees. ICNU argues that general industry averages show that employers typically pick up 75 to 80 percent of employee health care costs. ICNU argues on the basis of two consultants' studies of benefits paid by large corporations that there should be a disallowance of Company contributions of any more than 78 percent of premium payments made on behalf of employees.

187 PacifiCorp's union contracts require the Company to pay between 87.5 and 90 percent of each union member's premium. There is no evidence to suggest that PacifiCorp failed to be prudent in some way when negotiating these contracts. PacifiCorp contributes less, in the range from 80 to 90 percent, for non-union employees. Applying common sense, it seems PacifiCorp is acting prudently in not creating too much of a disparity among its employees, while nevertheless requiring non-union employees to bear a bit more of their own health care premiums. Mr. Wilson testified that the Company is moving toward an 80/20 sharing for all employees.

188 We reject ICNU's proposed adjustment.

viii. A&G Expense Cap

189 ICNU contends PacifiCorp has violated the MEHC merger order by exceeding the $222.8 million A&G expense rate cap to which the Company agreed in the merger review proceeding, Docket UE-051090. ICNU contends PacifiCorp is about $3.1 million over the cap, requiring a reduction in the Washington revenue requirement of $265,875.

190 PacifiCorp says ICNU is mistaken—the Company is below the cap.

---

[118] Exhibit No. 122.

191 The relevant question here is whether the Company seeks to recover in rates more than the amount of A&G expense allowed under the cap. A colloquy between Mr. Wrigley and Ms. Davison on cross examination gives us the answer.[119] Mr. Wrigley directed Ms. Davison to page 6 of Exhibit 137 and was prepared to do the math to prove PacifiCorp's point. However, Ms. Davison cut him off with the comment that "the numbers speak for themselves." Indeed, they do. Our examination of Exhibit 137 shows the A&G expense at $216,330,600, well below the cap. Accordingly, we reject ICNU's recommendation .

ix. Management Fee

192 According to ICNU, PacifiCorp includes in its Washington revenue requirement approximately $675,000 in ScottishPower management fees. ICNU argues these should be removed. ICNU's entire argument is: "The MEHC acquisition of PacifiCorp is a known and measurable event and with this change in ownership, the basis to include management fees from ScottishPower no longer applies." ICNU cites to the Commission Final Order in the last prior general rate proceeding in support of this proposition. However, the proposition under discussion in the prior order to which ICNU cites was ICNU's proposed consolidated tax adjustment. The Commission rejected ICNU's proposal, finding that the timing of the "change in corporate ownership means that the details of ICNU's calculations no longer apply and therefore the adjustment is moot." ICNU fails to explain how this applies to the issue of management fees in this proceeding.

193 PacifiCorp discusses in its reply brief that it continues to receive management services from its new owners and to pay management fees. Although these are paid to a new owner, MEHC, the amounts are limited by commitments made at the time of the merger to the levels paid to the prior owner. In other words, the management fees did not disappear with the change in ownership, they are simply paid to a new owner.

194 We find reasonable PacifiCorp's inclusion of management fee expense in rates. ICNU presents neither evidence nor persuasive argument to support its recommendation that this expense be disallowed.

e. Low-Income Program

195 PacifiCorp proposed in its initial filing to increase the low-income collection rate which funds the Low Income Bill Assistance (LIBA) program by a percentage amount equal to the total percentage of all residential price increases from general rate cases, including this case, since the program was implemented.[120] The Energy Project supports this proposal, but recommends that the Company increase funding even more, to a level in the range of that provided by Avista and PSE in their low-

---

[119] TR. 260:13 – 261:7.
[120] Exhibit No. 31 at 19:23–20:9 (Griffith Direct) Exhibit No. 47, column 2.

income assistance programs.[121] In its rebuttal testimony and on brief, PacifiCorp states that the Company will support any of these proposed funding levels.

196 The Company's original proposal would result in a monthly surcharge increase from 23 cents per month to 29 cents per month, an increase of 26 percent.[122] Using the Avista level, a monthly residential surcharge of 40 cents per month would result, an increase of 74 percent.[123] If the PSE level were applied, it would produce a monthly residential surcharge of 64 cents per month, an increase of 178 percent over the present surcharge level.[124]

197 Staff states that the LIBA program is 100 percent ratepayer funded via a surcharge levied in Schedule 91. Staff supports the Company's original proposal, arguing there is no cogent reason why PacifiCorp's funding must be in the range of Avista or PSE.

198 The Energy Project argues on reply that there are many cogent reasons to adopt one or the other of its proposals. As the Energy Project argued in its initial brief, 83 public comments were received in this case, the majority of which support an increase to PacifiCorp's low-income bill payment assistance funding. While this is a selective sample of PacifiCorp's customers, it nevertheless shows some support among the Company's ratepayers for increased levels of funding.

199 Mr. Eberdt testified that there is an ever-widening gap between the needs of PacifiCorp's low-income customers and the resources available to assist them. Rates have increased over time while funding levels have remained constant. Thus, either less assistance must be given to each needy customer if the number of assistance recipients remains constant, or fewer recipients can receive needed assistance. Either way, more customers will be unable to pay their bills. They will either voluntarily discontinue service or be disconnected.[125] The Energy Project argues that increased funding for the LIBA program has system-wide benefits because fewer customers will be disconnected and thus can continue to share the fixed cost burden borne by all ratepayers.

---

[121] Exhibit No. 231 at 6:1-8 (Ebert Direct).
[122] Exhibit No. 45 at 2:23–3:8 (Griffith Rebuttal).
[123] *Id.*
[124] *Id.*
[125] Albeit anecdotal, Public Counsel cites to evidence of this problem, quoting Sandra Richard of Yakima, as follows:

> Even tho [sic] I had OIC energy assistance it was not enough to cover everything. I got all but $50.00, there was no more funds anywhere in the Valley. They turned me off in January with the weather setting at 4 [degrees] F. My mobile is entirely electric so I have no way to eat except out of a can. I sat here for 1 month for a lousy $50.00, that is wrong.

Exhibit 1 at 5-6.

200 Public Counsel supports increasing the LIBA program funding level to a point where it is at least in the range provided by Avista as a percentage of revenues. Public Counsel argues that Mr. Ebert's unrebutted testimony and statements from members of the public that are in the record as part of Exhibit 1 (written comments from members of the public) support such a result.

201 Considering both the evidence and the advocacy, we find that increasing the level of the LIBA program so as to produce a 40 cent per month surcharge in Schedule 91 strikes a reasonable balance among the funding proposals. Increasing the LIBA program funding in this fashion should allow more customers who otherwise would be unable to pay their bills to remain on the system. We find merit in the argument that such customers' contribution to PacifiCorp's recovery of fixed costs benefits all customers.

f. MEHC Commitments

202 PacifiCorp requests that the Commission make a finding that the Company has complied with the following commitments from the MEHC transaction (Docket UE-051090): Commitment Wa4 – Affiliate Management Fee;[126] Commitment Wa6 – Affiliate Cross Charges;[127] Commitment Wa7 – A&G Cost Reduction;[128] and Commitment 37 – Long-term Debt Yield Reduction.[129] There is sufficient evidence to show these commitments have been met. No other party addresses this issue except in connection with the A&G cost cap, previously discussed.

203 The record shows that PacifiCorp has met or exceeded its obligations under these commitments. Accordingly, we find the Company has complied with these commitments made at the time of MEHC's acquisition of PacifiCorp.

g. Prudence of Resource Acquisitions

204 PacifiCorp and Staff recommend that the Commission find the Company has sufficiently demonstrated that the Eurus contract, the Leaning Juniper 1 project, and the New Grant Contracts were prudently acquired by the Company, and they should be considered used and useful for Washington customers.[130] The record includes evidence supporting this recommendation and there is no evidence suggesting imprudence in any of these acquisitions. Indeed, no party takes issue with the prudence of the Company's investments in these resources.

---

[126] Exhibit 131 at 15:1-5 (Wrigley Direct).
[127] *Id.* at 15:9-13.
[128] *Id.* at 15:14-16.
[129] Exhibit 111 at 6:1–7 (Williams Direct).
[130] Exhibit 261 at 47:1–50:20 (Buckley).

205 We find prudent PacifiCorp's investments in the Eurus contract, the Leaning Juniper 1 project, and the New Grant Contracts.

h. Rate Spread and Design

206 All parties who address the issue support PacifiCorp's as-filed rate spread and rate design. Both ICNU and Staff submitted testimony in support of the Company's proposal to apply a uniform percentage rate increase to most classes.[131] We find the proposed rate spread and rate design reasonable and will approve its use in setting rates in this proceeding.

FINDINGS OF FACT

207 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:

208 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including gas and electrical companies.

209 (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 are 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.

210 (3) The rates proposed by tariff revisions filed by PacifiCorp on October 3, 2006, and suspended by prior Commission order, are not just, fair or reasonable.

211 (4) PacifiCorp's existing rates for electric service provided in Washington State are insufficient to yield reasonable compensation for the service rendered.

212 (5) PacifiCorp requires relief with respect to the rates it charges for electric service provided in Washington State.

---

[131] Exhibit 201C at 13:10-18 (Iverson).

213 (6) The rates, terms, and conditions of service that result from this Order, based on a revenue deficiency of $14,189,025, are fair, just, reasonable, and sufficient.[132]

214 (7) The rates, terms, and conditions of service that result from this Order are neither unduly preferential nor discriminatory.

215 (8) PacifiCorp has met or exceeded its obligations under the following commitments made at the time MEHC acquired the Company: Commitment Wa4 – Affiliate Management Fee; Commitment Wa6 – Affiliate Cross Charges; Commitment Wa7 – A&G Cost Reduction; and Commitment 37 – Long-term Debt Yield Reduction.

216 (9) PacifiCorp's investments in the Eurus contract, the Leaning Juniper 1 project, and the New Grant Contracts were prudently made.

CONCLUSIONS OF LAW

217 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:

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

219 (2) The rates proposed by tariff revisions filed by PacifiCorp on October 3, 2006, and suspended by prior Commission order, were not shown to be fair, just or reasonable and should be rejected.

220 (3) PacifiCorp's existing rates for electric service provided in Washington State are insufficient to yield reasonable compensation for the service rendered and should be adjusted to provide the Company a reasonable opportunity to recover its full revenue requirement.

221 (4) The costs of PacifiCorp's investments in generation found on the record in this proceeding to have been prudently made and reasonable should be allowed for recovery in rates.

222 (5) PacifiCorp should have the opportunity to earn an overall rate of return of 8.060 percent based on the capital structure and costs of capital set forth in the

[132] *See* fn. 1, *supra.*

body of this Order, including a return on equity of 10.2 percent on an equity share of 46 percent.

223 (6) PacifiCorp should be authorized and required to make a compliance filing reflecting rates for electric service that will recover a revenue deficiency of approximately $14,189,025 and that otherwise satisfies the requirements of this Order. PacifiCorp and Staff are required to determine the precise amount of the Company's revenue requirement, which may vary slightly from the stated amount due to computational refinements during review of the compliance filing.

224 (7) PacifiCorp's compliance filing should include tariff sheets that increase the Schedule 91 surcharge to $0.40 per customer, per month to increase funding of the Company's low income billing assistance program.

225 (8) The rates, terms, and conditions of service that will result from this Order are fair, just, reasonable, and sufficient.

226 (9) The rates, terms, and conditions of service that will result from this Order are neither unduly preferential nor discriminatory.

227 (10) The Commission Secretary should be authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Order.

228 (11) The Commission should retain jurisdiction over the subject matters and the parties to this proceeding to effectuate the terms of this Order.

O R D E R

THE COMMISSION ORDERS:

229 (1) The proposed tariff revisions PacifiCorp d/b/a Pacific Power & Light Co. filed on October 3, 2006, and suspended by prior Commission order, are rejected.

230 (2) PacifiCorp is authorized and required to make a compliance filing including such new and revised tariff sheets as are necessary to implement the requirements of this Order. The stated effective date of the revised tariff sheets must allow Staff a reasonable opportunity to review the compliance filing and to inform the Commission whether Staff finds the revised tariff sheets fully conform to the requirements of this Order.

231 (3) The Commission Secretary is authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Order.

232 (4) PacifiCorp's Petition for Accounting Order in Docket UE-060817 is granted, in part, and denied, in part, as discussed in the body of this Order.

233 (5) The following commitments made at the time MEHC acquired PacifiCorp are deemed to have been met or exceeded: Commitment Wa4 – Affiliate Management Fee; Commitment Wa6 – Affiliate Cross Charges; Commitment Wa7 – A&G Cost Reduction; and Commitment 37 – Long-term Debt Yield Reduction.

234 (6) PacifiCorp's investments in the Eurus contract, the Leaning Juniper 1 project, and the New Grant Contracts are determined to have been prudent.

235 (7) The Commission retains jurisdiction over the subject matters and parties to this proceeding to effectuate the terms of this Order.

DATED at Olympia, Washington, and effective June ____, 2007.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for

reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.

APPENDIX

APPENDIX A

COMMISSION DETERMINATION OF REVENUE REQUIREMENT

		NOI Impact	Net Rate Base Impact	Commission's Revenue Requirement Impact
1	Per Books	32,647,342	$528,823,255	16,070,564
2	**Adjustments**			
3	**REVENUE**			
4	Temperature Normalization (u)	(143,284)	-	230,940
5	Pro Forma Reduction in Load (u)	(2,539,148)	-	4,092,509
6	Revenue Normalizing (u)	9,182,478	-	(14,799,993)
7	Centralia Gain (u)	(734,690)	-	1,184,147
8	Pole Attachment Revenue (u)	(519,401)	-	837,152
9	SO2 Emission Allowances (u)	(1,246,242)	(1,457,588)	1,819,319
10	**O & M**			-
11	Green Tag Removal (u)	26,741	-	(43,101)
12	Miscellaneous General Expense (u)	21,560	-	(34,750)
13	International Assignees (u)	95,029	-	(153,165)
14	Out of Period Expense Adjustment	210,066	-	(338,577)
15	Property Insurance (u)	(108,614)	-	175,060
16	Affiliate Fee Commitment (u)	7,018	-	(11,312)
17	DSM Amortization Removal (u)	3,224,446	-	(5,197,048)
18	Corporate Cost Commitment (u)	52,774	-	(85,059)
19	A&G Expense Commitment (u)	-	-	-
20	Proforma Wage Adjustment	(688,860)	-	1,110,281
21	Pension Expense			-
22	Incentive Compensation			-
23	Health Care			-
24	Value of Western Reserves to the East			-
25	Wyoming Resources (Actual Flow)			-
26	Wyoming Resources (Including Wyoming Loads)			-
27	Historical Loss factors	413,811		(666,966)
28	Short Term firm Transactions			-
29	SMUD Contract			-
30	Centralia Risk Sharing			-
31	GP Camus			-
32	Phantom Outages	168,282		(271,231)
33	Regulating Margin Modeling			-

34	PCAM ROE Adjustment			-
35	ScottishPower Management Fees			-
36	**POWER COSTS**			-
37	BPA Exchange (u)	(13,034,252)	-	21,008,146
38	James River Royalty Offset (u)	1,041,119	-	(1,678,039)
39	Removal of Colstrip #3 (u)	665,466	(9,493,893)	(2,305,764)
40	Misc. Power Supply	992,663	-	(1,599,939)
41	Revised CAGW & SO Factors	-	-	-
42	Water Year Adjustment	-	-	-
43	**TAX ADJUSTMENTS**			-
44	Interest True Up	(321,202)		517,702
45	Utah Gross Receipts Tax (u)	193,151	-	(311,313)
46	Reclassified Deferred Income Tax (u)	-	(16,435)	(2,135)
47	Malin Midpoint (u)	292,576	(1,462,882)	(661,582)
48	Flow-through Deferred Tax Adj. (u)	1,217,863	(10,531,719)	(3,330,904)
49	IRS Settlement Amortization	-	-	-
50	Year-end Deferred Tax (u)	-	(377,919)	(49,089)
51	Renewable Energy Tax Credit (u)	629,057	-	(1,013,892)
52	Low Income Tax Credit (u)	23,835	-	(38,416)
53	Production Activity Deduction	184,797	-	(297,849)
54	FIT on MEHC interest adjustment			-
55	**RATE BASE**			-
56	Cash Working Capital	-		-
57	Remove Deferred Debits (u)	-	(2,809,600)	(364,947)
58	Bridger Mine Rate Base	-	18,327,771	2,380,648
59	Grid West Loan (u)	(84,642)	112,424	151,026
60	North Umpqua Relicensing (u)	77,984	(128,191)	(142,344)
61	Yakama Sale (u)	6,090	(441,866)	(67,211)
62	Customer Advances (u)	-	984,551	127,886
63	Centralia Transmission Line Sale (u)	712	(38,277)	(6,120)
64	Leaning Juniper (u)	(938,473)	21,388,434	4,290,804
65	Miscellaneous Rate Base Adj. (u)	427,294	-	(688,697)
66	Colstrip 4 AFUDC Adj. (u)	33,000	(481,839)	(115,776)
67	Trojan Removal (u)	276,886	671,500	(359,052)
68	MEHC Transition Savings	1,879,604	1,592,618	(2,822,609)
69	Remove Working Capital	-	(3,952,812)	(513,442)
70	Remove Current Assets	-	(12,087,579)	(1,570,091)
71	ISWC	-	-	-

72	Customer Deposits	(24,364)	(2,001,969)	(220,773)
73	EEI Dues	21,905	-	(35,306)
74	13 Month Average Deferred Tax	-	(78,865)	(10,244)
75	Total	**33,630,377**	**526,539,117**	**14,189,449**
76				
77	Conversion Factor			0.6204380
78				
79	*Capital Structure*	Company	Company	
80	Long-term Debt / Cost	50.00%	6.335%	3.168%
81	Short term Debt / Cost	3.00%	4.500%	0.135%
82	Preferred Stock / Cost	1.00%	6.455%	0.065%
83	Common Stock / Cost	46.00%	10.200%	4.692%
84	Weighted Average Cost of Capital			8.059%
85				
86		**Proforma Interest adjustment**		
87		Rate base		526,539,117
88		adjustment 3.6		1,457,588
89		adjusted rate base		527,996,705
90		Weighted cost of debt		3.303%
91		Proforma Interest		17,437,091
92		Actual interest		18,354,812
93		Increase (decrease) interest expense		(917,721)
94				
95		Federal Income tax		321,202
96				
97		Net operating income		(321,202)
98				
99		Gross Revenue Requirement Increase		
100		Proforma Rate Base		526,539,117
101		Authorized Rate of Return		8.059%
102		Net Operating Income Requirement		42,433,787
103		Proforma Net Operating Income		33,630,377
104				
105		Recommended Increase (decrease)		8,803,410
106		Conversion Factor		0.6204380
107		Increased Revenue Requirement	$	14,189,025

GLOSSARY

TERM	DESCRIPTION
CAEW	Control Area Energy – West. An allocation factor used in the WCA interjurisdictional cost allocation methodology. The CAEW factor is a 100 percent energy weighting of Oregon, Washington and California retail loads based on each states' share of the west control area temperature normalized annual megawatt hours. Note that Staff refers to this as the Control Area Generation—West or CAGW allocation factor.
Deferral Account	An accounting convention that allows a utility, with authorization from the Commission, to record costs during one period for possible recovery in rates during a subsequent period. Permission to defer costs does not carry a guarantee that the costs will later be allowed in rates or that unamortized deferral balance will be allowed to earn a return as rate base.
ERM	Energy Cost Recovery Mechanism. The ERM is a power cost adjustment mechanism (PCAM) established pursuant to a Settlement Stipulation between Avista, Staff, Public Counsel, and ICNU, which was adopted by the Commission on June 18, 2002, in the Fifth Supplemental Order in Docket UE-011595.
GRID	A computer model that PacifiCorp uses to estimate future power costs.
ICNU (Industrial Customers of Northwest Utilities)	Industrial Customers of Northwest Utilities is a regional organization whose members are large industrial customers of various utilities, including PSE.
ISCW	Investor supplied working capital. The average amount of capital provided by investors in the company, over and above the investments in plant and other specifically identified rate base items, to bridge the gap between the time expenditures are required to provide service and the time collections are received for that service. The accounting definition of working capital is current assets less current liabilities. According to Goodman, the accounting definition is seldom used in rate regulation. Staff's ISCW analysis in this proceeding does not conform to the accounting definition, as it considers both current (i.e., short-term) assets and long-term assets.[133]

[133] Goodman, Leonard Saul, The Process of Ratemaking, Vol. 2, pp. 828-838 (Public Utilities Reports, Inc., 1998).

LIBA	Low income bill assistance. This is a ratepayer-funded program to provide financial assistance to qualified PacifiCorp customers who have difficulty paying their utility bills.
MEHC	MidAmerican Energy Holding Company. A part of the Berkshire Hathaway group of companies, MEHC purchased PacifiCorp in 2005 in a transaction the Commission examined and approved in Docket UE-051090
NOI	Net operating income. A company's operating income after operating expenses are deducted, but before income taxes and interest are deducted.
PCORC	Power cost only rate case. This is a procedural option that allows for expedited consideration between general rate proceedings of the prudence and rate treatment of costs associated with major generation acquisitions by PSE. The Commission adopted the PCORC process as part of a comprehensive settlement of PSE's general rate proceeding in Docket Nos. UE-011570 and UG-011571. *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-011570 & UG-011571, Twelfth Supp. Order (2002).
PCAM (power cost adjustment mechanism)	An accounting mechanism that tracks the difference between actual annual power costs and approved baseline annual power costs and that determines a rate surcharge or credit depending on the magnitude and direction of the difference.
Revenue Requirement	The amount of revenue a utility needs to meet its expenses, cost of capital and taxes for the normalized test year.
Ring Fencing	Techniques used to insulate the credit risk of an issuer from the risks of affiliate issuers within a corporate holding company structure. There are several techniques that can be employed separately, or together, to insulate a utility from the risks of affiliate issuers within a holding company system. These include pro-active regulatory oversight, financial restrictions, structural separations, and operational controls
ROE (return on equity)	The rate of earnings realized by a utility on its shareholders' assets, calculated by dividing the earnings available for dividends by the equity portion of the rate base. The Commission establishes an authorized rate of return for recovery in rates.
SMUD	Sacramento Municipal Utility District.

SO	System Overhead. An allocation factor used in the WCA interjurisdictional cost allocation methodology. The SO factor is calculated by dividing the gross plant (excluding SO allocated plant) allocated to Washington by total Company gross plant.
WCA (West control area) allocation	An interjurisdictional cost allocation methodology that eliminates all resources and loads in PacifiCorp's east control area, though it does include resources that serve but are not physically located in the WCA states (Washington, Oregon, California).