BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, vs. PACIFICORP dba Pacific Power & Light Company, Respondent.	DOCKET UE-061546
In the Matter of the Petition of PACIFICORP dba Pacific Power & Light Company For an Accounting Order Approving Deferral of Certain Costs Related to the MidAmerican Energy Holdings Company Transition.	DOCKET UE-060817 (Consolidated)

OPENING BRIEF

ON BEHALF OF COMMISSION STAFF

April 23, 2007

ROBERT M. MCKENNA
Attorney General

DONALD T. TROTTER
Senior Counsel
Office of the Attorney General
Utilities & Transportation Division

1400 S Evergreen Park Drive SW
P.O. Box 40128
Olympia, WA 98504-0128
(360) 664-1189

TABLE OF CONTENTS

I. INTRODUCTION 1

II. INTERJURISDICTONAL COST ALLOCATION METHODOLOGY 2

A. The WCA Methodology Satisfies The Used And Useful Standard 4

1. PacifiCorp's Western control area resources directly serve Washington customers 6

2. Resources outside the Western control area such as Colstrip and Jim Bridger are properly included in the WCA methodology because there is sufficient transmission capacity for those resources to serve Washington 7

3. The WCA Methodology provides Washington a "full share" of West side hydroelectric resources 7

B. The Commission Should Accept Staff's Proposed Modifications To PacifiCorp's Version Of The WCA Methodology (Staff Adjustments 5.4 And 5.5) 8

C. Public Counsel And ICNU's Attacks On The WCA Methodology Are Ill-Conceived And Inappropriate 9

1. Public Counsel and ICNU's comparison of variable power costs in the Eastern and Western control areas fails to prove the WCA method is "contrived" or produces "spurious results" 9

2. The Dave Johnson and Wyodak plants should not be included because they have not been shown to be used and useful for service in Washington 11

3. Public Counsel and ICNU's "Interconnection Benefits" Adjustment is Inappropriate 13

D. Conclusions 13

III. PCAM ISSUES 14

A. A PCAM Is Appropriate For PacifiCorp, So Long As The Commission Adjusts The Rate Of Return To Compensate Ratepayers For Shouldering Significant Additional Risk 15

1. Staff's PCAM is an appropriate response to PacifiCorp's exposure to power cost variations in Washington 15

a. The evidence contradicts Public Counsel and ICNU's claim that PacifiCorp is exposed to power cost volatility insufficient to merit a PCAM 16

2. Staff's PCAM is a short-run accounting procedure to account for short-run cost changes 19

3. Staff's PCAM does not include recovery of the fixed costs of new resources 20

4. Staff's equity ratio adjustment satisfies the Commission's cost of capital offset standard 20

a. The Commission's cost of capital offset standard makes good financial sense 21

b. Cost of equity estimation methods are insufficient tools for measuring PCAM risk 22

c. Staff measured the extent to which the PCAM changes the *status quo* between ratepayer and shareholder risk related to excess power costs 22

d. The Company's challenge to Staff's case confirms the PCAM shifts substantial risk to ratepayers 24

e. PacifiCorp's authorized rate of return does not include PCAM risk 26

5. Staff's PCAM is consistent with least cost planning and Commission conservation policies 28

B. Staff's Proposed PCAM Is Properly Designed 28

C. The Commission Can Successfully Implement Staff's PCAM 30

1. The Commission should accept Staff's proposed PCAM recovery threshold and implementation date. The Company's proposed mechanics for the PCAM are acceptable 30

2. It is also acceptable for the PCAM to use a re-dispatch of the GRID model to measure power cost variations 30

D. Staff's Proposed PCAM Answers Each Of The Commission's Questions From The Last Case 33

E. The PCAM Issues Are Ripe For Resolution. The Commission Should Decline Public Counsel's Invitation To Wait Until After The WCA Allocation Method Is In Effect Before Approving A PCAM 34

IV. REVENUE REQUIREMENTS 34

A. Rate of Return 35

B. Revenue Adjustments (3.1 Through 3.6) 36

C. O&M Adjustments (4.1 Through 4.10, 9.2, And 9.3; ICNU's Adjustments For Pension Expense, Incentive Compensation, And Health Care) 36

1. ICNU's Pension Expense Adjustment: This adjustment is not a proper *pro forma* adjustment because it is based on speculation, rather then known and measurable changes 36

2. ICNU's Incentive Compensation Adjustment: Staff proposed a similar adjustment in the last case. The Commission rejected it 37

3. ICNU's Health Care Adjustment: This adjustment is not correctly calculated 38

D. Net Power Cost Adjustments (5.1 Through 5.6, 9.8, ICNU 6-13) 39

1. Adjustment 5.6: If the Commission approves a PCAM, it should also accept this adjustment, which removes power supply costs associated with extreme water conditions, which are recovered under the PCAM 39

2. ICNU Adjustment 6: This adjustment improperly removes short-term firm transactions that are essential to service in Washington 40

3. ICNU Adjustment 7: The Commission should not remove the SMUD Contract because ICNU has not shown the contract to be imprudent or that it does not involve the Western control area 41

E. Tax Adjustments (7.1 Through 7.10, ICNU Income Tax Expense Adjustment) 42

1. PacifiCorp Adjustment 7.6: The Commission should reject this adjustment because it constitutes retroactive ratemaking. If the Commission decides to accept it, the income that created the additional tax needs to be included 42

2. ICNU's Income Tax Expense Adjustment: The Commission should reject this adjustment because it fails to compute taxes based on PacifiCorp's' net income. If the goal is to compute PacifiCorp's share of "taxes actually paid," this adjustment also fails to achieve that goal 43

F. Rate Base (Adjustments 8.1 Through 8.17, 9.9) 45

1. Working Capital Issues (Adjustments 8.1, 8.3, 8.14, 8.15 and 8.16) 45

a. Staff's ISWC method explicitly calculates the amount of working capital investors provide 46

b. PacifiCorp only assumes its working capital amounts are provided by investors 46

c. The Company did not fully support its lead lag study 48

d. The Company's lead-lag method and the Company's direct addition of current assets to rate base provide improper incentives 49

2. Adjustment 8.13, MEHC Transition Savings, and PacifiCorp's Accounting Petition in Docket UE-060817 50

a. The Commission should permit the Company to recover some level of transition costs from ratepayers 52

b. The Commission should deny deferral and rate recovery of all transition costs PacifiCorp booked before May, 2006 52

c. The Commission should limit executive severance benefits to the same percentage of pay that non-executives received 54

d. Staff's transition cost adjustment is not affected by Commitment Wa 7a 55

e. Recommendations 56

3. End of period deferred taxes 57

V. REVENUE ALLOCATION AND RATE DESIGN 58

A. Uncontested Proposals 58

B. The Commission Should Increase The Schedule 91 Low Income Bill Assistance Program Rates By 21.2 Percent On Average 58

VI. CONCLUSIONS 60

APPENDICES

Appendix A: Comparison of Net Operating Income, Rate Base, and Revenue Requirements

Appendix B: PacifiCorp Results of Operations for Ratemaking Purposes (Twelve Months Ended March 2006 – Washington)

I. INTRODUCTION

1 This case involves PacifiCorp's request for general rate relief. If the Commission grants a rate increase, it would be the Company's first general rate increase since November 2004.[1] During this time frame, energy and related equipment and supply costs have increased substantially.[2] It is therefore not surprising that Staff found the Company has a revenue deficiency of $12,324,910, which justifies a 5.4 percent overall increase in revenues.[3] It is also not surprising that Staff found it in the public interest to attempt to settle this case for a 4.4 percent rate increase.[4]

2 What is surprising is Public Counsel and ICNU's case. The effect of their presentation is a 9.9 percent rate decrease.[5] Frankly, it is difficult to give their presentation much credence.

3 In any event, the Commission is now asked to resolve some key issues, principal among them are issues surrounding the appropriate cost allocation method, whether a purchased cost adjustment mechanism (PCAM) is appropriate and the parameters under which the PCAM should be approved for the Company.

4 In the last PacifiCorp rate case, the Commission denied the Company's request for a PCAM, and any rate relief at all for that matter, because, *inter alia*, the Company had not justified its "rolled-in" method of allocating rate base and expenses to Washington.[6] Indeed,

---

[1] Exh. 49.
[2] Reitan, Exh. 61 at 3:3-12.
[3] The adjustments supporting these figures are explained in this brief. Appendices A and B contain a detailed development of these figures. Appendix A compares the parties' cases at the net operating income (NOI) level. Page 3 of Appendix B shows a summary revenue requirement deficiency calculation. The 5.4 percent increase is calculated in Appendix B at 1, column 4, and in Table 6.
[4] Settlement Stipulation (January 17, 2007) at 6, ¶ 16.
[5] *See* Appendix A at 5. The 9.9 percent figure is shown after line13. Public Counsel and ICNU do not share all of the same witnesses, so it is not clear at this time that Public Counsel supports all of ICNU's adjustments.
[6] *Wash. Utilities & Transp. Comm'n v. PacifiCorp,* Docket UE-050684, Order 04 (April 17, 2006) (hereafter "Order 04 in Docket UE-050684") at 27, ¶ 64 and at 38, ¶ 99 (reason 3).

the Company has argued for many years that to determine the cost of serving Washington customers, it is appropriate to "roll in" all the Company's resources, including resources serving new loads in Utah, and allocate a share to Washington. The Commission's order in the last case broke that cycle.

5 Now, for the first time since the Scottish Power era, PacifiCorp proposes a control area-based allocation method: the Western Control Area (WCA) methodology. Staff reviewed that methodology and, with a few revisions, recommends the Commission accept it for purposes of setting rates. Staff also proposes a PCAM that is well-designed, is consistent with the WCA methodology, and satisfies all other Commission PCAM standards.

6 The contested revenue requirements issues are limited in number, in part because PacifiCorp did not include a large number of *pro forma* adjustments in its case. The relatively small number of contested adjustments does not mean those issues are unimportant. For example, Staff answered the Commission's call for further analysis on working capital issues, and Staff proposes an equitable ratemaking treatment of the high levels of severance pay the Company doled out to departing executives.

7 For the reasons stated below, the Commission should accept Staff's analysis and grant no more than a 5.4 percent rate increase for PacifiCorp's Washington customers.

II. INTERJURISDICTONAL COST ALLOCATION METHODOLOGY

8 PacifiCorp is a multi-jurisdictional utility providing electric service in Washington and five other states. The Commission needs an acceptable cost allocation methodology in

order to set rates for a utility such as PacifiCorp.[7] In the last case, the Company sought approval of the Revised Protocol; a system-wide allocation method whereby the Company allocated a share of all of its resources to Washington. The Commission rejected the Revised Protocol because, *inter alia*, that method did not satisfy the "used and useful" standard in RCW 80.04.250.

9 The Commission observed that PacifiCorp failed to meet its burden of proving that all of its resources either directly serve Washington, or provide quantifiable benefits to Washington.[8] The Commission noted that meeting this burden was a complex undertaking as it applies to resources in the Eastern control area, because the Company acquired most of those resources to serve Utah or other Eastern control area states. Moreover, significant transmission constraints impeded the exchange of power between the East and the West.[9]

10 Several significant factors remain unchanged from the last case: The Company still operates in two control areas; significant transmission constraints still exist between these control areas; and for the most part, the Company has yet to prove there are measurable benefits to Washington from the Company's Eastside resources.

11 However, one major factor *has* changed: The Company has abandoned the Revised Protocol for Washington, along with all other company-wide allocation methods. Instead, the Company proposes a control area-based cost allocation methodology called the "Western Control Area (WCA) methodology."[10]

12 As we explain below, the WCA methodology is a reasonable response to the concerns the Commission articulated in Docket UE-050684, and it meets the standards the

[7] "Without a method to allocate costs (rate base and expenses) to Washington, we are not able to establish whether the proposed rates would be fair, just or reasonable ..." Order 04 in Docket UE-050684 at 27, ¶ 64.
[8] *Id.* at 21, ¶ 49.
[9] *Id.* at 22, ¶ 53.
[10] *E.g.* Kelly, Exh. 11 at 3:20 to 4:19.

Commission enunciated in that case. Moreover, the WCA method is flexible enough to handle future resource additions, and it is consistent with Staff's proposed PCAM.

13 In short, the WCA methodology is appropriate for purposes of setting retail electric rates for PacifiCorp's Washington customers. The Commission should accept the WCA methodology, with Staff's proposed modifications. The Commission should also establish a formal five-year period for reviewing the effectiveness of the WCA methodology and to provide a forum for exploring possible refinements to that method.

14 Of course, as the Commission is keenly aware, support for the WCA methodology is not universal in this case. Public Counsel and ICNU oppose the method, but offer no allocation method of their own. They recommend the Commission reject the WCA allocation methodology and thus deny any rate increase whatsoever.[11] Alternatively, on the grounds that simply denying a rate increase is "overly generous," they offer mostly draconian and otherwise improper "corrections" to the WCA methodology, in an effort to garner a significant rate decrease.[12]

15 Below we explain why the Commission should accept the WCA methodology, and reject Public Counsel and ICNU's recommendations.

A. The WCA Methodology Satisfies The Used and Useful Standard.

16 It is evident from the Commission's last PacifiCorp rate order that the "litmus test" for a cost allocation system is that it must satisfy the used and useful standard in RCW 80.04.250. As we explain in more detail below, the WCA methodology passes that test. Indeed, the WCA methodology reflects a common sense application of the used and useful standard, as the Commission explained it.

---

[11] Falkenberg, Exh. 161 at 15:30-34.
[12] *Id.* at 16:1 to 28:11.

17 For example, the WCA methodology allocates to Washington a share of all PacifiCorp's resources located within the Western control area because the Company uses such resources to serve Washington customers. Company resources located outside the Western control area can also be included. Thus, if a resource "straddles" the two control areas, some portion of the costs and benefits of that resource can be directly assigned to the West. Or, if a dedicated transmission path exists for a specific Eastside resource into the West, or a unit-specific energy transfer is proposed, a direct assignment of the related costs and benefits of such a resource may be considered. The Colstrip and Jim Bridger plants are examples of such resources that are allocated to Washington under the WCA methodology.

18 On the other hand, if a resource is simply part of the Company's Eastside resource portfolio and does not satisfy the conditions described above, it is treated the same as other Eastside resources. That is, the benefits from Eastside resources can be established through the potential for economic purchases by the West of Eastside power, taking into consideration the overall Eastside portfolio costs and market prices. However, the WCA method does not directly assign to Washington the costs or benefits of such Eastside resources.

19 This straightforward approach that underlies the WCA methodology makes sense; it is rooted in the "used and useful" standard, and it will assure the WCA methodology remains a valid implementation of the Commission's policy to fairly allocate costs between jurisdictions.

1. PacifiCorp's Western control area resources directly serve Washington customers.

20 PacifiCorp operates in two control areas: the Western control area and the Eastern control area. Washington, Oregon and California are located in the Western control area.[13] A cost allocation methodology based on the Western control area satisfies the used and useful standard for Washington because the control area "[identifies the] costs and benefits associated with direct service to Washington customers."[14] Indeed, that is a principal feature of a control area: "The resources within a control area are used to provide benefits to the system within that control area."[15]

21 This is a direct byproduct of PacifiCorp's need to comply with the North American Electric Reliability Corporation (NERC) Minimum Operating Reliability Code. As PacifiCorp explains, pursuant to NERC requirements "[t]he control area operator [*i.e.*, PacifiCorp] relies on all of the resources within the west control area to maintain reliability for PacifiCorp's Washington loads."[16] As a result, PacifiCorp has designed, constructed and now operates the West control area as a whole, and has acquired Western control area resources and transmission rights on that basis.[17] As Mr. Widmer observed: "it is rather obvious that resources located within the WCA reliably serve Washington customers and therefore are used and useful to Washington."[18]

22 This evidence provides a compelling factual basis for a Commission finding that PacifiCorp's Western control area resources are used and useful to serve Washington. Indeed, as the Commission concluded in the last case, the used and useful standard is met

---

[13] Buckley, Exh. 261 at 11:4-6; Kelly, Exh. 10 at 4:6-7.
[14] Buckley, Exh. 261 at 10:5-9.
[15] *Id.* at 11:1-2.
[16] Kelly, Exh. 11 at 6:1-3.
[17] *Id.* at 6:3-10.
[18] Widmer, Exh. 88 at 13:14-16.

"[w]hen a facility is actually used to provide service, [because] its costs and benefits can be readily identified and allocated appropriately."[19] The WCA methodology satisfies this standard because the resources in the Western control area directly serve Washington customers.

2. Resources outside the Western control area such as Colstrip and Jim Bridger are properly included in the WCA methodology because there is sufficient transmission capacity for those resources to serve Washington.

23 The WCA methodology includes certain resources physically located within the Eastern control area. The main examples are the Colstrip and Jim Bridger coal plants. These facilities have sufficient firm transmission to serve both Eastern and Western control areas, or, as Staff put it, they "span" both control areas.[20] These resources and their associated transmission facilities are designed to serve Washington.[21] Thus, the WCA methodology satisfies the used and useful standard by including them in the model.

3. The WCA Methodology provides Washington a "full share" of West side hydroelectric resources.

24 Another key Commission standard for an acceptable cost allocation methodology is that Washington must be given "full value" of the Company's Western control area hydroelectric resources.[22] The WCA methodology fully complies with this requirement as well, because it assigns to the Western control area 100 percent of the costs and benefits of such resources, and thereby Washington receives its full share.[23]

---

[19] Buckley, Exh. 261 at 22, ¶ 51.
[20] *Id.* at 11:15-20; Kelly, Exh. 10 at 4:10-16.
[21] *Id.*
[22] Order 04 in Docket UE-050684 at 28, ¶ 70: "We expect the Company to include the full value of hydroelectric resources in the Western control area in any inter-jurisdictional cost allocation model it develops for Washington."
[23] Buckley, Exh. 261 at 14:4-16; Kelly, Exh. 10 at 7:3-9.

B. The Commission Should Accept Staff's Proposed Modifications To PacifiCorp's Version Of The WCA Methodology (Staff Adjustments 5.4 and 5.5).

25 Staff proposed two adjustments to the WCA methodology as originally proposed by PacifiCorp. Staff Adjustment 5.5, "Revised CAGW & SO Allocators" changes the allocation of fixed production costs to 75 percent demand and 25 percent energy. This aligns the allocation of demand and energy costs with how the allocation traditionally has been accomplished.[24] This adjustment was also proposed by Public Counsel and ICNU,[25] and PacifiCorp accepted it.[26]

26 Staff's second modification is Adjustment 5.4, "Miscellaneous Power Supply, Eastern Market Modification." This adjustment, sometimes referred to by Staff as the "Eastern market bubble" adjustment, credits the Western control area for economic sales to the Eastern control area.[27] This adjustment recognizes some benefits of the Eastern control area, despite the restricted transmission capability that limits power transfers between control areas. It is a reasonable attempt to measure the benefits that exist. The Company accepts the adjustment.[28]

27 It is conceivable that a "bubble" for sales from the East to the West also could be implemented. However, on this record, the existence of such a bubble is more theoretical than actual, due to the lack of available interconnection capacity in the East to West direction.[29] For now, the Commission should accept Adjustments 5.4 and 5.5 as refinements to the original version of the WCA methodology presented by the Company.

[24] Buckley, Exh. 261 at 6:10-17.
[25] Falkenberg, Exh. 161 at 26:12 to 27:5.
[26] Wrigley, Exh. 136 at 1:15. PacifiCorp's rebuttal testimony implements Staff's proposed Adjustment 5.5 through the direct application of the "Control Area Generation – West" allocation factor in the Company's revenue requirements model. Appendix B to this brief presents Staff's final recommended revenue requirement increase on this same basis, thereby eliminating the need for a separate Adjustment 5.5.
[27] The methodology is set forth in Exhibit 262.
[28] Widmer, Exh. 88 at 3:5 to 6:13.
[29] Buckley, Exh. 265 at 14:1-5.

C. Public Counsel And ICNU's Attacks On The WCA Methodology Are Ill-Conceived And Inappropriate.

28 Public Counsel and ICNU attack the WCA methodology on several grounds, all but one of which were exposed as ill-conceived, one-sided or otherwise inappropriate.[30] In total, Public Counsel and ICNU make $23.5 million in adjustments to the WCA model.[31] However, most revealing is their overall charge that the WCA methodology "is a shallow attempt to curry favor with the Commission by trading simplicity for higher cost to customers."[32]

29 Typically, a party resorting to such invective is trying to deflect attention from the defects in its own case. That is what is happening here. Moreover, by offering such remarks, Public Counsel and ICNU do a true disservice to the many months and years of diligent work by the Commission, its Staff and others to achieve a reasonable cost allocation methodology for the benefit of Washington ratepayers.

30 In any event, we proceed to address the major challenges Public Counsel and ICNU to the WCA methodology.

1. Public Counsel and ICNU's comparison of variable power costs in the Eastern and Western control areas fails to prove the WCA method is "contrived" or produces "spurious results."

31 Public Counsel and ICNU's major critique of the WCA methodology is based on their comparison of variable power costs in each control area. Mr. Falkenberg notes that the WCA methodology produces variable power costs in the Western control area that are 62 percent higher than the Eastern control area ($20.60 per MWh for the Western control area;

---

[30] The only valid point made by ICNU (with which Staff agrees and the Company accepts) involves Mr. Falkenberg's "CAGW Allocation Factor," which is shown in Exh. 161 at 5, Table 1, lines 2 and 3. Staff calls this Staff Adjustment 5.5, "Revised CAGW & SO Allocators." The Company implements the CAGW factor in Exh. 137.

[31] Falkenberg, Exh. 161 at 5, Table 1, line entitled "WCA Model Corrections" of $23,482,877.

[32] *Id.* at 14:23-25.

$12.70 for the Eastern control area).[33] From this, Public Counsel and ICNU conclude that the WCA methodology was "contrived … to produce these spurious results."[34] In fact, there is nothing "contrived" or "spurious" about either the WCA methodology or its results. The problem is with Public Counsel and ICNU's comparison, which is obviously flawed because it completely ignores fixed costs.

32 As Staff carefully explained, the Eastern control area relies on coal resources that have high fixed costs and low variable costs. By contrast, the Western control area relies on a mix of coal and hydro resources, gas-fired resources that have low fixed costs and high variable costs, and power contracts, whose entire cost is included as part of net power supply expense.[35] Consequently, if one focuses exclusively on variable costs, as Public Counsel and ICNU have elected to do, one would expect to find precisely what ICNU and Public Counsel did find: a higher variable cost in the Western control area. In other words, there is nothing "contrived" or "spurious" about this result.

33 The Commission should note that when all relevant costs are included, the power cost difference between control areas is only 1.2 percent, not 62 percent, as Public Counsel and ICNU allege.[36] Staff substantiated the Company's analysis by comparing the Company's proposed rates developed using the WCA methodology, to the rates in the other PacifiCorp states, which are based on the Revised Protocol. Staff concluded that "Washington's rates would still compare very favorably to those in the Company's other

[33] Falkenberg, Exh. 161 at 11:3 to 12:11.
[34] *Id.* at 12:8-10.
[35] Buckley, Exh. 265 at 7:21 to 8:4.
[36] Widmer, Exh. 88 at 9:11 to 10:2, including Table 3.

jurisdictions. Washington's total power costs would NOT be 62 percent higher than those jurisdictions in the eastern control area, as Mr. Falkenberg's testimony might suggest."[37]

34 In the last case, the Company's ongoing, rapid growth in the Eastern control area was well documented.[38] Under the WCA methodology, Washington will not be called upon to pay for the new resources PacifiCorp will need to acquire to serve those new loads. Like the WCA methodology itself, that result is neither "spurious" nor "contrived." On the contrary, that is a good result for Washington customers, based solidly on the legal standards applicable to Washington.

2. The Dave Johnson and Wyodak plants should not be included because they have not been shown to be used and useful for service in Washington.

35 As we described earlier, Public Counsel and ICNU propose $23.5 million in "adjustments" to the WCA method. Over half this amount is because they include the variable power costs of the Dave Johnson and Wyodak plants in the WCA methodology, in spite of the fact that these plants are located in the Eastern control area. To accomplish this, Public Counsel and ICNU offer two adjustments totaling $12 million.[39] They try to justify these adjustments by saying these plants were once included in Washington's rate base, power is delivered from them under the GRID model, and the costs are "more than commensurate with the benefits."[40]

36 Public Counsel and ICNU's proposal to include Dave Johnston and Wyodak is flawed in both assumption and execution. First, their proposal rests on the flawed assumption that how PacifiCorp may have operated these plants in the past dictates how

[37] Buckley, Exh. 265 at 8:9-13 (emphasis in the original).
[38] Order 04 in Docket UE-050684 at 19, ¶ 44.
[39] Falkenberg, Exh. 161 at 25. The NOI effect of these adjustments is shown in Appendix A.
[40] *Id.* at 22-23.

they must be allocated now. Formerly, these plants were part of Pacific Power & Light Company. However, now they are a part of the Company's Eastern control area.[41] Now, PacifiCorp does not need these resources to support Washington loads.[42] Now, the Company needs these projects to serve Wyoming loads.[43]

37 Second, for any Eastern control area resource to be allocated to Washington, Public Counsel and ICNU would have to establish that Washington needs the power, and there is adequate transmission capacity to deliver that power when it is needed. Public Counsel and ICNU failed to establish either of these two conditions. At most, all Public Counsel and ICNU have shown is that the Dave Johnson and Wyodak projects are available to the West only during limited, off-peak hours.[44]

38 Third, while it is theoretically possible for Eastern control area resources to provide benefits to Washington, there is no basis for assuming Dave Johnson and Wyodak would be the specific resources to do that, as opposed to another resource located in the Company's Eastern control area.[45]

39 In short, the record does not show these projects are used and useful for Washington. In any event, Public Counsel and ICNU's analysis is flawed in execution. For example, Public Counsel and ICNU's adjustment fails to allocate the fixed costs of the Dave Johnson

---

[41] Buckley, Exh. 265 at 13:1-4.
[42] *Id.* at 8:20-22: "the WCA GRID model runs show that Washington's load requirements and Western control area balancing needs can be met by this mix [*i.e.,* not including Dave Johnson and Wyodak] of resources and contracts."
[43] Widmer, Exh. 88 at 26:16-23.
[44] Buckley, Exh. 265 at 15:6-9. Indeed, any inter-control area transfer methodologies must be consistent. That is, if the West benefits from "market price" sales from West to East, then market prices should be used to evaluate the potential for economic purchases from East to West.
[45] Buckley, Exh.265 at 9:11-20; Widmer, Exh. 88 at 26:4-26.

and Wyodak plants, and it includes Wyoming loads, though Wyoming is not even located in the Western control area.[46]

40 The bottom line is that Public Counsel and ICNU have provided an insufficient basis either in theory or in calculation for allocating the Dave Johnson and Wyodak plants to Washington.

3. Public Counsel and ICNU's "Interconnection Benefits" Adjustment is Inappropriate.

41 The other major "adjustment" to the WCA method proposed by Public Counsel and ICNU is entitled "Interconnection Benefits." This adjustment amounts to another $8.6 million decrease compared to the WCA as proposed.[47] PacifiCorp explained in painstaking detail why this adjustment is inappropriate.[48] Staff concurs with PacifiCorp's analysis. The Commission should reject the Interconnection Benefits adjustment.

42 Instead, the Commission should accept Staff's Adjustment 5.4, "Miscellaneous Power Supply, Eastern Market Modification," which is designed to recognize potential benefits for sales into the East through the Company's limited East/West interconnection transfer capacity. As we noted earlier, it may also be appropriate to develop a similar methodology for economic purchases from East. The WCA methodology is flexible enough to accommodate such an adjustment if and when it can be justified.

D. Conclusions.

43 The WCA methodology meets all Commission standards for an acceptable cost allocation methodology. It satisfies the used and useful statute; it provides Washington "full value" of the Western control area hydroelectric resources; and it does not and will not

[46] Buckley, Exh. 265 at 14:14 to 15:5.
[47] Falkenberg, Exh. 161 at 5, Table 1, line 1, "Interconnection Benefits - $8,567,749."
[48] Widmer, Exh. 88 at 16:2 to 25:14.

burden Washington ratepayers with costly future resources designed to serve Utah and elsewhere in the Eastern control area. Public Counsel and ICNU have presented no substantial reason why the Commission should not adopt the WCA methodology. The Commission should accept the WCA methodology for purposes of setting rates in Washington.

III. PCAM ISSUES

44 There are three basic issues before the Commission regarding the PCAM: 1) Is a PCAM appropriate for PacifiCorp?; 2) What is the appropriate PCAM design?; and 3) How should the Commission implement its cost of capital offset policy, *i.e.,* that "ratepayers should receive the benefit of a reduction in cost of capital, as a power cost adjustment introduces rate instability for ratepayers and earnings stability for stockholders?"[49]

45 As we explain below, a PCAM is justified because PacifiCorp is exposed to significant power cost variations due to factors beyond its control.[50] A PCAM can and should be fairly structured to address the Company's exposure to power cost variability. The PCAM should include a dead band of $4 million, a 50/50 sharing band from $4 million to $10 million, and a 90/10 sharing band above $10 million.[51] Because this PCAM design shifts significant risk from shareholders to ratepayers,[52] the Commission should reduce the Company's ratemaking equity ratio to 42 percent to compensate ratepayers for accepting this additional risk, which was previously borne by shareholders.[53]

---

[49] Order 04 in Docket UE-050684 at 35, ¶ 91 (April 17, 2006).
[50] Buckley, Exh. 261 at 31-36.
[51] *Id.* at 36-43.
[52] Elgin, Exh. 291 at 21-28.
[53] *Id.* at 29-33.

A. A PCAM Is Appropriate For PacifiCorp, So Long As The Commission Adjusts The Rate Of Return To Compensate Ratepayers For Shouldering Significant Additional Risk.

46 In its order in Docket UE-050684, the Commission set forth the standards for evaluating a PCAM. In the discussion that follows, we demonstrate that only Staff's PCAM proposal complies with those standards.

1. Staff's PCAM is an appropriate response to PacifiCorp's exposure to power cost variations in Washington.

47 The Commission's first standard recognizes that "the purpose [of a PCAM] is to recognize variability in the cost of operating *existing* power supply resources as a result of abnormal weather conditions that are out of a utility's control. Ratepayers understand the connection between weather and rates."[54] The Commission clarified that "abnormal weather" is not the only factor; market volatility and other events beyond the Company's control would also qualify.[55]

48 The record amply demonstrates that PacifiCorp meets this standard. As Mr. Buckley explained, a significant amount of PacifiCorp's net power supply costs are both variable and beyond the Company's control. This variability relates to hydro conditions, as well as the sales and purchase prices the Company collects and pays to address hydro variability, and short-term changes in customer loads.[56] As PacifiCorp's power supply portfolio changes over time, the Company's ability to control other variable power supply costs is also limited.[57]

49 For example, Staff compared the Company's best and worst water years to calculate a "swing" in net power supply expense of around $26.6 million, which is about 30 percent

[54] Order 04 in Docket UE-050684 at 34-35, ¶ 91 (citations omitted).
[55] *Id.* at 37, ¶ 97.
[56] Buckley, Exh. 261 at 32:17-33:3.
[57] *Id.* at 33:4-6.

of the Company's base level power costs for Washington.[58] Fully $16 million of this excess power cost variation is on the down side.[59] At a $16 million level of excess power costs, the Company is well into a financial emergency.[60] Moreover, as Mr. Buckley explained, utilities with hydro production such as PacifiCorp have inherently more cost exposure than utilities with the same amount of thermal generation, because the cost of replacement power for hydro is so much higher.[61]

50 This is ample evidence that a PCAM will address significant power cost volatility for PacifiCorp.

a. The evidence contradicts Public Counsel and ICNU's claim that PacifiCorp is exposed to power cost volatility insufficient to merit a PCAM.

51 Public Counsel testified that the Commission "found" a "threshold" of hydro resource dependence in adopting PCAMs for Avista Corp. (Avista) and Puget Sound Energy, Inc. (PSE), and PacifiCorp does not meet that alleged "threshold."[62] However, that testimony was categorically refuted when Public Counsel was forced to admit that it was based on no finding of fact in any Commission order, and there is no specific "threshold."[63] Obviously, Public Counsel also had to admit it cannot quantify the "threshold" the Commission never "found" in the first place.[64]

---

[58] *Id.* at 34:6-13.
[59] Buckley, Exh. 265 at 5:1-12.
[60] Elgin, Exh. 291 at 18:1-9 (discussing PacifiCorp's need for extraordinary relief at a $13 million level of excess power costs).
[61] Buckley, Exh. 265 at 3:15 to 4:6. PacifiCorp calculates an even greater swing, some $48 million for Washington, albeit using a more simplified analysis. Widmer, Exh. 84 at 27.
[62] Johnson, Exh. 241 at 7:5-8.
[63] Johnson, TR 288:1 to 290:25 and Exh. 244, part b.
[64] Johnson, Exh. 245, part b, referring to Exh. 244, part c.

52 Public Counsel errs again when it suggests that PacifiCorp's hydro dependence should be measured on a total company basis, and by that measure, PacifiCorp resources are only 0.2 percent hydro.[65] There are several problems with Public Counsel's suggestion.

53 First, as Mr. Buckley testified, Public Counsel's newly-adopted Company-wide perspective "is irrelevant to setting Washington rates using any form of Western control area based allocation methodology."[66]

54 Second, it is difficult to decide which Public Counsel position is to be believed. In the last case, Public Counsel strongly advocated against the use of company-wide data. For example, Public Counsel argued against a company-wide allocation model, and argued for the allocation to Washington of a full share of West side hydro resources (*i.e.,* the "hydro endowment"). Public Counsel also argued that PacifiCorp uses essentially two resource portfolios: one for the East and one for the West.[67]

55 Staff suggests that these earlier positions advocated by Public Counsel are the right ones. The Commission should apply them and evaluate PacifiCorp's hydro dependence from a Washington or Western control area perspective, and reject Public Counsel's contrary viewpoint of more recent vintage.

56 Another major problem with Public Counsel's position is that it simply overlooks the significant evidence of PacifiCorp's exposure to power cost variations. In addition to the evidence we discussed above, Staff also cited Exhibit 83, which shows that Company-owned and contracted hydro in the Western control area comprises 34 percent of PacifiCorp's winter capacity, 21 percent of its summer peak capacity, and 18 percent of its

[65] Johnson, Exh. 241 at 7:10 to 8:2.
[66] Buckley, Exh. 265 at 3:12-14.
[67] Johnson, TR 292:11 to 292:8.

annual energy.[68] Again, hydro resources of this magnitude place on a utility more power cost variation than thermal resources of the same magnitude. Ultimately, Public Counsel's analysis is meaningless, in part because it ignores this elemental fact.[69]

57 It is true that some level of power cost variability is reflected in the Commission's traditional power cost normalization process in ratemaking, and the risk of highly extreme water conditions is low.[70] However, there remains significant variability in overall power costs,[71] and Staff appropriately applied this fact in designing its proposed PCAM.[72]

58 By contrast, Public Counsel inappropriately applies this fact to suggest a PCAM is not warranted if extreme variations are to occur only infrequently.[73] This is simply a subset of Public Counsel and ICNU's broader argument that PacifiCorp is subject to less hydro variability than Avista or PSE, and therefore PacifiCorp cannot have a PCAM.[74]

59 One way for the Commission to respond to this argument is to conclude that if Public Counsel and ICNU are correct, and PacifiCorp's exposure to power cost variability is very low, then that variability will simply be subsumed in Staff's proposed $4 million dead band. Public Counsel and ICNU have nothing to worry about. The more direct response is that Staff's analysis proves power cost variability is still a significant factor for PacifiCorp.

60 For its part, ICNU analyzes the Company's exposure to market prices using a 10 percent variance in the price of electricity.[75] However, this analysis is completely unrealistic

[68] Buckley, Exh. 265 at 3:6 to 4:6.
[69] *Id.*
[70] Buckley, Exh. 261 at 35:1-8.
[71] Buckley, TR 334:5-15.
[72] Buckley, Exh. 261 at 35:4-6.
[73] *E.g.,* Public Counsel's cross-examination of Mr. Buckley, TR 335:10-12.
[74] Falkenberg, Exh. 161 at 64-69 and Johnson, Exh. 241 at 5-10.
[75] Falkenberg, Exh. 161 at 65-66 and Exh. 170.

because it ignores the much wider variances actually experienced by the Company as recently as last summer.[76]

61 As the Commission has observed, PacifiCorp has fewer hydro resources than Avista, for example.[77] However, that fact does not tell the whole story, because if Avista experiences a decline in hydro generation, it can increase generation from one of its thermal generating units that are not being fully utilized under average conditions. Avista's incremental cost is the incremental variable cost of running that thermal resource. By contrast, PacifiCorp's thermal generation resources located in the Western control area are primarily base load resources. Therefore, PacifiCorp's replacement energy must come from fully-loaded short-term contracts, which, as Mr. Buckley explained, can and do have a greater effect on net power costs than incremental generation from other types of owned resources or market resources.[78]

62 In sum, when the Commission fairly evaluates the Washington-specific evidence, it is clear that PacifiCorp is subject to power cost variations significant enough to justify a PCAM.

2. Staff's PCAM is a short-run accounting procedure to account for short-run cost changes.

63 The Commission's second standard is that "power cost adjustment mechanisms are *short-run* accounting procedures to address *short-run* cost changes resulting from unusual weather."[79] Again, the Commission has clarified that unusual weather is not the only factor; other events beyond the Company's control would qualify, such as market volatility.[80]

---

[76] Widmer, Exh. 88 at 47:18 to 48:1.
[77] Order 04 in Docket UE-050684 at 36, ¶ 93.
[78] Buckley, Exh. 265 at 3:15 to 4:6.
[79] Order 04 in Docket UE-050684 at 35, ¶ 91 (emphasis in the original) (citations omitted).
[80] *Id.* at 37, ¶ 97.

64 Staff's proposed PCAM meets this standard because it tracks short-term (*i.e.* monthly) changes in PacifiCorp's power supply costs, with an annual true-up.[81] These short-term power costs include variations in hydro-related production costs, as well as thermal fuel costs, some contract costs, market prices, loads and forced outages.[82]

3. Staff's PCAM does not include recovery of the fixed costs of new resources.

65 Another Commission PCAM standard is that "it is not appropriate to include new resources in a power cost adjustment mechanism. New resources must be considered in general rate cases or power cost only rate cases."[83] Staff's proposed PCAM meets this standard because it does not include the fixed costs of new resources, although Staff includes variable costs associated with minor, short-term resource additions (*i.e.,* resources with under a two-year term, and under 50 average Megawatts).[84]

66 By contrast, the Company's proposed PCAM violates the Commission's standard because it contains a fixed cost production component that is designed to recover the costs of all new resources.[85] The Commission should not accept the Company's PCAM for that reason.[86]

4. Staff's equity ratio adjustment satisfies the Commission's cost of capital offset standard.

67 The fourth Commission PCAM standard is that "ratepayers should receive the benefit of a reduction in cost of capital, as a power cost adjustment introduces rate instability

[81] Buckley, Exh. 261 at 29:11-21.
[82] *Id.* at 20:1-5 and Widmer, Exh. 88 at 44:13-13-19.
[83] Order 04 in Docket UE-050684 at 35, ¶ 91 (citations omitted).
[84] Buckley, Exh. 261 at 30:1-8.
[85] Widmer, Exh. 81 at 31:12-21 and Kelly, Exh. 11 at 11:16-18.
[86] Nonetheless, Staff is sympathetic with PacifiCorp's concern for more timely recovery of new resource costs, particularly in light of some of the mandatory resource portfolio standards contained in Initiative 937, which was recently enacted in Washington. However, such recovery must be through a separate mechanism.

for ratepayers and earnings stability for stockholders."[87] In PacifiCorp's prior rate order, the Commission emphasized that "we will consider the need for a reduction in the cost of capital as a part of the overall analysis of how the mechanism shifts risks between investors and ratepayers."[88]

68 Only Commission Staff provided detailed analysis directly responsive to this standard and directive. Only Staff directly calculated how the much risk the PCAM shifts between ratepayers and shareholders.

69 As we explain below, the Commission's standard requiring a cost of capital reduction to compensate ratepayers for bearing additional risk is financially sound, and it is fair. The Commission should implement that standard in this case using the tools Staff has made available, and reduce the Company's ratemaking equity ratio to 42 percent to address the risk shifting nature of the PCAM.

a. The Commission's cost of capital offset standard makes good financial sense.

70 The Commission's cost of capital offset standard makes good financial sense, because a PCAM reduces a utility's exposure to excess power costs,[89] and thus reduces the potential for the utility to suffer corresponding adverse financial consequences. This lowers the utility's cost of capital, because it reduces the utility's risk of default, thereby enhancing the utility's ability to access capital markets in times of persistent adverse power cost conditions.[90]

---

[87] Order 04 in Docket UE-050684 at 35, ¶ 91 (citations omitted).
[88] *Id.* at 37, ¶ 97.
[89] The Company conceded this effect of the PCAM. Hadaway, TR 168:14-18.
[90] Elgin, Exh. 291 at 6:5-9 and at 11:21 to 12:11.

b. The DCF is an insufficient tool for measuring PCAM risk.

71 It is obvious that a PCAM shifts risk from shareholders to ratepayers. That is the whole point: to reduce the utility's exposure to power cost variations. The challenge is how to measure the impact of that risk shift on the cost of capital. To measure the cost of capital offset, Staff did not use a cost of equity estimation method such as the Discounted Cash Flow (DCF) method. DCF and other methods are simply not up to the task, either because these tools are too blunt for purposes of determining the specific impact of PCAM risk shifting, or because the available sample size is simply too small,[91] or both.[92]

72 It is also apparent that help in implementing the Commission's cost of equity offset standard will not come from decisions by other state commissions. Other commissions have yet to adopt the same ratepayer protections as the Commission, so they do not require the sort of risk shifting analysis that the Commission requires.[93]

73 Nonetheless, as Staff showed, there are still ways to measure the risk shift and its impact on cost of capital. The Commission should use the tools Staff provides to implement the Commission's cost of capital offset standard.

c. Staff measured the extent to which the PCAM changes the *status quo* between ratepayer and shareholder risk related to excess power costs.

74 Staff presents a straightforward methodology to measure the impact of power supply risk to Pacific based upon operating margin (*i.e.,* pre-tax interest coverage). Using this methodology, Staff measures the degree to which the PCAM insulates the Company from loss of operating margin. Staff then develops a benchmark for comparing proposed PCAMs

---

[91] Hadaway, TR 193:8-17.

[92] Even assuming the methods used in the last case were useful here, PacifiCorp errs in relying on the record in the last case because the cost of capital analysts did not focus on the PCAM issue. Hadaway, TR 173:20-23.

[93] *See* Hadaway, TR 195:17 to 196:15.

to the *status quo*, and for calculating an appropriate offset to the cost of capital, by means of a reduction in equity ratio.

75 As Staff explained, in order to measure the risk shifting that occurs under a PCAM, the Commission must first analyze excess power cost responsibility in the non-PCAM environment. In the non-PCAM environment, when excess power costs create financial hardship, a utility such as PacifiCorp can seek deferred accounting or interim rate relief.[94] At that point, ratepayers begin to become responsible for excess power costs. Before then, shareholders are responsible for excess power costs. Consequently, the point where the utility would be granted extraordinary relief is the "benchmark" against which the PCAM can be measured to determine the degree of risk shifting.[95]

76 Staff showed that a 2.50 coverage ratio is a reasonable measure of this benchmark. First, this benchmark is consistent with the 2.0 times interest coverage requirement specifically applicable to PacifiCorp.[96] This means PacifiCorp cannot issue any new debt if the Company's financial condition deteriorates to a 2.0 times coverage. Obviously, PacifiCorp would seek relief from the Commission well before that point.

77 Second, Staff's benchmark is consistent with experience. For example, in Docket UE-991606, the Commission permitted Avista to defer excess power costs. Avista had a 2.3 times coverage ratio at that point.[97]

78 Third, Staff's benchmark is consistent with the low end of what an average "BBB"-rated utility achieves.[98] Again, if the coverage dips below that level, the utility would be

[94] Elgin, Exh. 291 at 15:1-11.
[95] *Id.*
[96] Williams, Exh. 119 at 13, second to last ¶.
[97] Elgin, Exh. 291 at 17:7-9.
[98] *Id.* at 24:10-14.

expected to seek extraordinary rate relief because its ability to finance and continue its public service obligations is threatened.

79 Using this 2.50 coverage ratio benchmark, Staff calculated that without a PCAM, PacifiCorp shareholders would be expected to absorb $13 million of excess power costs.[99] Under Staff's proposed PCAM, however, the Company could incur $25 million in excess power costs before it would reach the same level of financial distress.[100] That is proof positive that Staff's PCAM substantially alters the current ratepayer/shareholder risk allocation related to adverse power costs.

80 To address this substantial risk transfer from shareholder to ratepayer, Staff calculated that a 4 percent reduction in equity ratio was necessary.[101] This is consistent with the Commission's policy, which requires that ratepayers do not pay twice for risk; once for the "cushion" provided by a 46 percent equity ratio and a 10.2 percent return on equity, and again for the power cost variances that return and equity ratio are intended to cover.[102] As Staff summarized, "rates should not support both the costs of a 46 percent equity ratio and a PCAM."[103]

d. The Company's challenge to Staff's case confirms the PCAM shifts substantial risk to ratepayers.

81 For its part, PacifiCorp provided no risk analysis, no benchmark and no quantification of risk shifting under the Company's proposed PCAM. Instead, PacifiCorp challenged Staff's 2.50 coverage benchmark, focusing on the "BBB" justification Staff used to explain why it selected this benchmark. PacifiCorp's primary point is that Standard &

[99] Elgin, Exh. 291 at 18:1-20:4 and Exh. 293 at 1.
[100] Elgin, Exh. 291 at 30:7-12 and Exh. 293 at 11.
[101] Elgin, Exh. 291 at 29-32 and Exh. 293 at 12.
[102] Elgin, Exh. 291 at 20:8-14.
[103] *Id.* at 20:14-15.

Poor's uses multiple financial metrics to justify a bond rating, and no longer uses the times interest coverage as a specific metric.[104]

82 While the Company's point is accurate, it misses the mark. Staff's analysis is not an "S&P bond rating analysis." Staff's analysis is a risk shifting analysis directly responsive to the Commission's cost of capital offset standard. The Commission should therefore ignore PacifiCorp's rebuttal arguments that Staff's analysis is flawed because S&P no longer use pre-tax interest coverage in its analysis. Moreover, Staff's "BBB" justification is only one of three independent justifications for a 2.5 coverage benchmark. PacifiCorp offered no benchmark, no calculation of risk shifting, and failed to address the other two Staff justifications for a 2.50 coverage benchmark.

83 On the other hand, while PacifiCorp's analysis failed in some respects, it was highly successful in substantially validating Staff's analysis. For example, in Exhibit 54, Dr. Hadaway imputes debt associated with purchased power contracts and makes other "corrections" to Staff's analysis.[105] The bottom line of his analysis is that under Staff's PCAM, and at a $25 million level of excess power costs, PacifiCorp would have a 2.25 coverage ratio, somewhat lower than the 2.50 coverage ratio Staff calculated.[106] This amply confirms Staff's central conclusion: Staff's PCAM shifts significant risk from shareholder to ratepayer.

84 Put another way, Staff's analysis led it to a "benchmark," the point at which ratepayers would be expected to "chip in." The Company's analysis in Exhibit 54 simply

[104] Hadaway, Exh. 51 at 9:1-11.
[105] Dr. Hadaway calls this "off balance sheet debt" or "Total System OBS Debt." See the second line of Exhibit 54.
[106] Hadaway, Exh. 54 at 1, last line, compared to Staff's Exh. 293 at 11:15.

suggests ratepayers might be called upon to "chip in" a bit earlier than that.[107] Under the Commission's cost of capital offset standard, an adjustment to rate of return is required in these circumstances. The Commission should apply its standard and reduce PacifiCorp's equity ratio to 42 percent for ratemaking purposes.

e. PacifiCorp's authorized rate of return does not include PCAM risk.

85 As we mentioned above, PacifiCorp completely failed to bear its burden to address the Commission's standard requiring a cost of capital reduction occasioned by the Company's proposed PCAM. Indeed, at no time did the Company calculate the extent to which its proposed PCAM shifts risk to ratepayers. Instead, the Company mostly tried to avoid the issue.

86 For example, in its direct case, the Company adopted a delaying strategy: The Company admitted it had not addressed the PCAM's impact on cost of capital, and proposed to delay that determination for five years.[108] In rebuttal, the Company reversed course, claiming for the first time that no rate of return adjustment is necessary because PCAM risk is already reflected in the rate of return the Commission authorized in the last case, Docket UE-050684. The Company's claim is based on the fact that most of the utilities in the comparable group used by the cost of capital witnesses in the last case had a PCAM of some variety.[109] In fact, the record proves PacifiCorp's claim to be profoundly deficient.

87 First, the utilities in the comparable group in the last case were not chosen because they had a PCAM.[110] As Mr. Gorman explained, "I relied on Dr. Hadaway's proxy group

---

[107] Perhaps the Company could have used this information to justify a different PCAM structure. However, on rebuttal, the Company substantially acceded to Staff's PCAM structure. Widmer, Exh. 88 at 43:5-9.
[108] Kelly, Exh. 11 at 11:21 to 12:4.
[109] Kelly, Exh. 12 at 2:22 to 3:5 and Hadaway, Exh. 51 at 2:15-17.
[110] Hadaway, TR 170:15 to 171:7.

and found it to be a reasonable risk proxy group for PacifiCorp, and that was based on PacifiCorp's risk that existed at that time, which did not include a fuel adjustment mechanism."[111] Indeed, one of the utilities in the comparable group without a PCAM also had the lowest ROE.[112] Obviously, PCAM risk was not dictating the returns for these companies.

88 Second, the cost of capital witnesses in the last case provided a range of estimates for return on equity: from 8.95 percent to 11.125 percent.[113] Yet PacifiCorp says each of these estimates reflects PCAM risk![114] While the Company has left us all to wonder what risks were included in some of these estimates but not others, the point is that the cost of capital analysis in the last case was simply not refined enough to prove the theory the Company proffered for the first time in rebuttal.

89 Finally, in the last case, the Commission adopted an ROE of 10.2 percent, knowing full well it was not adopting a PCAM. This is corroborated by the Commission's directive that it would consider the PCAM's impact on ROE in this case.[115] It follows that the Commission-determined 10.2 percent ROE does not reflect the reduced risk associated with a PCAM.

90 With no other way out, the Company tried to argue that Staff's recommended equity ratio reduction violates Commitment 18 in Docket UE-051090 (the MEHC acquisition docket).[116] However, PacifiCorp debunked its own argument when it finally conceded the obvious: Commitment 18 has nothing to do with the Commission's use of a hypothetical

---

[111] Gorman, TR 303:24 to 303:3. Mr. Gorman was a cost of capital witness in Docket UE-050684.
[112] Exh. 59, Ameren, using Dr. Hadaway's Traditional Constant Growth DCF Model, and Exelon, using Dr. Hadaway's Low Near-Term Growth Two-Stage Growth DCF Model.
[113] Exh. 57.
[114] Hadaway, TR 170:4-7, referring to Exhibit 57, which lists the ROE recommendations of each witness in Docket UE-050684.
[115] Order 04 in Docket UE-050684 at 37, ¶ 97.
[116] Kelly, Exh. 11 at 4:19-22 and Hadaway, Exh. 51 at 2:18-23 and at 8:15-18.

capital structure in ratemaking.[117] Because Staff's equity ratio adjustment is for ratemaking purposes *only*, there is no violation.

91 In the end, PacifiCorp fails to sustain its burden to address the issue the Commission directed the parties to address: "the need for a reduction in cost of capital as a part of the overall analysis of how the mechanism shifts risks between investors and ratepayers." In effect, Staff assumed the Company's burden and proved that a reduction in the equity ratio is required. The Commission should accept Staff's capital structure adjustment, and use a 42 percent equity ratio in the ratemaking capital structure.

5. Staff's PCAM is consistent with least cost planning and Commission conservation policies.

92 The final Commission PCAM standard is that "power cost adjustment mechanisms should not interfere with least cost planning, conservation or other regulatory goals."[118] Staff's proposed PCAM satisfies this standard because it enhances the Company's ability to more timely address the treatment of costs and benefits available through least cost planning, conservation and related Commission policies.[119]

B. Staff's Proposed PCAM Is Properly Designed.

93 Staff's proposes the following PCAM structure:[120]

Dead band:	\$0 to ± \$4 million
50/50 sharing band:	Over ± \$4 million to ± \$10 million
90/10 ratepayer/shareholder sharing band:	Over ± \$10 million

94 Staff carefully analyzed PacifiCorp's specific circumstances when designing this PCAM. For example, Staff's proposed PCAM design takes into account PacifiCorp's

[117] Kelly, TR 158:7 to 159:24. *See also* Exhibit 55 (PacifiCorp's Commitments in the MECH acquisition docket) Commitment 18(a) (equity ratio commitment is between MEHC and PacifiCorp only) and Commitment Wa 26 (Commitments do not bind the other parties in ratemaking proceedings).
[118] Order 04 in Docket UE-050684 at 35, ¶ 91 (citations omitted).
[119] Buckley, Exh. 261 at 31:8-15.
[120] *Id.* at 39:18-22.

hydro-electric generation availability.[121] Moreover, as we explained earlier, Staff selected the $4 million dead band in part to accommodate concerns about the Company's need to use "pseudo-actual" results for certain of its power costs.

95 Staff's 50/50 sharing band is designed in part to avoid creating an incentive for the Company to manage its resource portfolio to "get to the outer band" (*i.e.,* to achieve maximum ratepayer sharing as quickly as possible). This sharing band design has been used successfully by Avista in its ERM.[122]

96 Staff's outer band is designed to provide maximum (90/10) ratepayer sharing at the $10 million level of excess power costs. Staff chose this level in part because it is consistent with Staff's Adjustment 5.6, "Water Year Adjustment." In this adjustment, Staff calculated base power costs by removing the costs and benefits of "extreme" water years, which Staff measured as any water year located outside one standard deviation from the mean.[123] In other words, Staff's Water Year Adjustment is synchronized with the structure of Staff's proposed PCAM because the costs and benefits of these extreme water years will be captured in the outer band of the PCAM. These costs and benefits need not be counted again in setting base rates.

97 In rebuttal, PacifiCorp accepted Staff's PCAM design, but conditioned that acceptance on cutting Staff's Water Year Adjustment by more than half.[124] The Company makes this adjustment by excluding different water years than Staff removed, to derive what

---

[121] Buckley, Exh. 261 at 29:3-4.
[122] *Id.* at 41:8-21.
[123] *Id.* at 42:8 to 43:3, at 22:1 to 25 and Exh. 264.
[124] Widmer, Exh. 88 at 43:5-9. The Company emphasized it was still opposing Staff's equity ratio adjustment, and wanted a new resource recovery mechanism. *Id.* at 43:17-19. However, as to the new resource recovery mechanism, the Company acknowledged it simply wished to have the right to file for such a mechanism. Widmer, TR 226:8-21.

the Company calls a "normal" distribution of water years.[125] As we discuss in greater detail later,[126] the Company's adjustment is not appropriate because the goal is to eliminate extreme water years, not manufacture a new water year distribution. Consequently, the Commission should reject the Company's adjustment and accept Staff's Water Year Adjustment 5.6.

C. The Commission Can Successfully Implement Staff's PCAM.

98 A few PCAM implementation issues are presented for Commission resolution. The evidence shows that Staff's proposed PCAM can be successfully implemented.

1. The Commission should accept Staff's proposed PCAM recovery threshold and implementation date. The Company's proposed mechanics for the PCAM are acceptable.

99 Staff proposes a PCAM start date of September 1, 2007, and a threshold for recovery of PCAM deferral balances when the balance reaches $6 million.[127] The Company agreed with these proposals[128] and there does not seem to be any controversy surrounding them.

100 In other respects, the Commission should accept the Company's definition of variable net power costs, the Company's use of the GRID model, the retail revenue adjustment, and the Company's proposed method for certain long-term variable resource costs and wholesale sales transactions.[129]

2. It is also acceptable for the PCAM to use a re-dispatch of the GRID model to measure power cost variations.

101 Public Counsel and ICNU criticize the proposed PCAMs because the Company is required to re-dispatch its power cost model in order to calculate Washington-specific power

---

[125] Widmer, Exh. 88 at 8:4-18.
[126] The detailed discussion of Adjustment 5.6 is in ¶¶ 131-36.
[127] Buckley, Exh. 261 at 45:22 to 46:2, at 26:22-23 and at 27:6-9.
[128] Widmer, Exh. 88 at 41:10-14.
[129] Buckley, Exh. 261 at 38:11 to 39:4.

costs consistent with the WCA allocation methodology. While there is no dispute that this necessarily involves the use of some values that are not "actual,"[130] the record shows that Public Counsel and ICNU are making more of this issue than is warranted.

102 First, this use of "pseudo-actuals" is a byproduct of using a Western control area allocation model, because the Company accounts for its power supply costs on an integrated basis. Nonetheless, the Company can still identify a substantial amount of actual costs and resources, even though a complete and separate dispatch is necessary to produce full Western control area results.[131] The Company has adequately described how the re-dispatch would be accomplished,[132] and the results are reproducible.[133]

103 Moreover, a "pseudo-actual" issue similar to the one argued by Public Counsel and ICNU will exist regardless of the allocation methodology that is used, because the Company does not incur power costs by jurisdiction. Therefore, in some respects, all PCAMs for a multi-jurisdictional utility are, by definition, using some sort of allocated (*i.e.*, "pseudo-actual") costs.

104 It is true that a re-dispatch procedure is not specifically required under the PCAMs for Avista and PSE. However, nothing in the Commission's PCAM policy prohibits this procedure; the Commission has simply not addressed this issue before. In this regard, the Commission should note that only by inserting the word "actual" into the words of a prior Commission order was ICNU able to manufacture an inconsistency with any prior

---

[130] Johnson, Exh. 241 at 10:20 to 11:7 and Falkenberg, Exh. 161 at 57:2 to 61:17.
[131] Widmer, Exh. 88 at 45:11-21.
[132] *Id. at* 46:1-18.
[133] Buckley, Exh. 265 at 6:1-8.

Commission PCAM decision.[134] This is just one more reason why ICNU's approach is unfair to the parties and the Commission.

105 Finally, Commission rejection of a PCAM on the basis of the need for a re-dispatch of the power cost model is not a measured response. Staff more reasonably offered two ways to address any Commission concerns with the use of "pseudo-actuals." First, Staff recommended the Commission require the Company to continually improve its ability to develop and provide actual data.[135] Second, Staff increased the Company's proposed dead band by $1 million.[136] These actions are much more reasonable and measured than the "just say no" philosophy featured in ICNU's and Public Counsel's arguments.

106 In the end, the Commission should recognize that the substantial benefits of a PCAM substantially outweigh any concerns with the re-dispatch procedure. For example, Staff's PCAM is designed to provide better price signals to customers for the effect on power costs of changes in weather or energy market prices.[137] By contrast, the Commission's "normalization" process for determining power costs was never intended to provide a price signal during times of adverse power cost conditions.

107 Another benefit of a PCAM is that it enables the Commission to depart from the traditional normalization rate setting procedures for net power costs, a procedure fraught with uncertainties due to the long-term nature of the data.[138] For example, with a PCAM, the Commission no longer has to struggle with the effects of uncertain market price forecasts during extreme water years, or the issue of how many water years to include in the

---

[134] Falkenberg, Exh. 161 at 56:11-21 (Mr. Falkenberg refers to the Commission order using the term "actual short-term costs," but the Commission order used the terms "costs" and "short-term costs," not "actual costs" or "actual short-term costs." In any event, the Commission did not face this issue in the PCAMs for Avista and PSE, so those orders could not and did not resolve that issue).
[135] Buckley, Exh. 261 at 38:17-20.
[136] *Id.* at 40:15-20.
[137] *Id.* at 36:3-6.
[138] Buckley, TR 336:5-15 and TR 342:2 to 343:9.

normalization process. As long as a "reasonable" base year is chosen, the PCAM addresses the actual cost variations that may occur.

108 In the end, when the Commission fairly weighs the benefits and burdens of a PCAM, it is apparent Staff's proposed PCAM is in the public interest and should be approved.

D. Staff's Proposed PCAM Answers Each Of The Commission's PCAM Questions From The Last Case.

109 In the last case, the Commission expressed three concerns about the PCAM proposed in that case: "1) It should focus on short-term costs subject to market volatility or other extraordinary events that are beyond the Company's control, and should not include costs for new generation; 2) The 90/10 sharing band and the absence of a dead band do not adequately balance risks and benefits between shareholders and ratepayers, and; 3) An acceptable allocation methodology is a prerequisite to establishing a PCAM."[139]

110 Staff's case satisfies each of these concerns. First, as we explained earlier, Staff's PCAM focuses on short-term costs that are beyond the Company's control. Second, there is a $4 million dead band in Staff's proposed PCAM, as well as a 50/50 sharing band, and a 90/10 sharing band. Staff developed this structure based on careful analysis that balanced risks and benefits as much as possible. Nonetheless, like most PCAMs, Staff's proposed PCAM still shifts significant risk to ratepayers. Staff's equity ratio adjustment addresses that. Finally, the WCA methodology is appropriate and forms an acceptable basis for Staff's proposed PCAM.[140]

---

[139] Order 04 in Docket UE-050684 at 37, ¶ 97.
[140] Buckley, Exh. 261 at 32:5-8.

E. The PCAM Issues Are Ripe For Resolution. The Commission Should Decline Public Counsel's Invitation To Wait Until After The WCA Allocation Method Is In Effect Before Approving A PCAM.

111 In opposing the PCAM, Public Counsel says the Commission should delay its decision on PCAM design until after the Commission decides on a cost allocation method.[141] In opposing the settlement, Public Counsel says PCAM and cost allocation method issues "should be considered *at the same time*."[142]

112 At hearing, Public Counsel tried to deflect attention from these contradictory statements, by testifying that Public Counsel opposed the settlement because it required the Commission to approve a PCAM in concept, and Public Counsel did not find that acceptable.[143] The truth is, the settlement required no such thing.[144]

113 The Commission should reject Public Counsel's case for delay because it founders on contradiction. Public Counsel had its opportunity to present its own PCAM, and elected to offer no PCAM whatsoever. Staff's had its opportunity too, and proposed a PCAM that is sound, meets all Commission standards, and can be implemented without further delay. The Commission can and should approve Staff's proposed PCAM in this case.

IV. REVENUE REQUIREMENTS

114 The test year is the twelve months ending March 31, 2006. All parties presenting adjustments have used this test year.[145] Staff's analysis showed that PacifiCorp has a

[141] Johnson, Exh. 241 at 3:2-5.
[142] Public Counsel and ICNU letter to ALJ Moss (January 22, 2007) at 2, last ¶ (emphasis added).
[143] Johnson, TR 297:6-14 to 298:5.
[144] The Settlement Stipulation (dated January 17, 2007) provided only that Staff and Company would support a PCAM and negotiate in good faith to design one. Settlement Stipulation at 7-8, ¶ 20. It did not purport to require the Commission to adopt a PCAM, nor did it require Public Counsel to agree to a PCAM.
[145] Staff: Schooley, Exh. 321 at 6:7-15; PacifiCorp: Wrigley, Exh. 131 at 7:22 to 8:3; ICNU: Iverson, Exh. 203, 209, 211 and 213; Public Counsel/ICNU: Falkenberg: Exh. 161 at 1:15-18.

revenue deficiency of $12,324,910, which justifies an overall rate increase of 5.4 percent. Below we address the elements that justify that revenue deficiency.

115 To further assist the Commission, Staff supplies two appendices. Appendix A summarizes the differences between the parties regarding net operating income (NOI), rate base and the revenue requirement calculation. Appendix B presents a rerun of Staff Exhibit 322, showing an updated, detailed portrayal of all Staff adjustments.[146]

A. Rate of Return.

116 The parties addressing this issue agree that an 8.06 percent overall rate of return is appropriate, before any adjustments are made for the impact of a PCAM.[147] This figure reflects the cost of equity and capital structure approved by the Commission in Docket UE-050684, with updates to the cost of preferred stock, long-term debt and short-term debt.[148]

117 As we explained earlier in ¶¶ 67-97, if the Commission approves Staff's proposed PCAM, the Commission should set rates using a 42 percent equity ratio. This results in an overall rate of return of 7.90 percent:[149]

Component	Ratio (%)	Cost (%)	Weighted cost (%)
LT Debt	54.0	6.33	3.421
ST Debt	3.0	4.50	0.135
Preferred	1.0	6.46	0.065
Common	42.0	10.2	4.284
Rate Return			7.90

[146] Appendices A and B reflect minor changes to Staff's hearing presentation. These changes are explained in the notes at the end of Appendix A. In addition, Staff corrects and updates Adjustment 7.1, "Interest True Up," to reflect the actual interest expense shown in PacifiCorp's rebuttal Exhibit 137 at 22:1218.
[147] PacifiCorp: Williams, Exh. 111 at 5:16 (table); Staff: Elgin, Exh. 291 at 33:5-8. ICNU's witness Mr. Gorman offered a PCAM-related adjustment to the 10.2 percent return on equity approved in the last case, but ICNU did not otherwise challenge that 10.2 percent figure. Gorman, Exh. 118 at 2:15 to 3:8.
[148] The calculation is shown in Mr. Williams' table in Exhibit 111 at 5:16. The Company calculated the 6.33 percent cost of long term debt in that table based on a limited updating of costs; *i.e.*, that 6.33 percent figure was not based on a full *pro forma* analysis. For example, the Company's calculation does not include the effect of the Company's recent $600 million debt issuance (Exh. 118) or the effect of many of the various debt obligations that PacifiCorp retired or will retire after late 2006 through the rate year. (The maturity dates for each issuance is shown in Exh. 112). Nonetheless, Staff took these changes into account and confirmed the Company's original cost estimate. Staff still supports that calculation for purposes of setting rates in this case.
[149] Elgin, Exh. 291 at 33:15-22.

118 The Commission should apply this 7.90 percent rate of return to rate base to determine PacifiCorp's revenue needs.

B. Revenue Adjustments (3.1 through 3.6).

119 Staff reviewed and investigated these adjustments,[150] and none are contested.[151]

C. O&M Adjustments (4.1 through 4.10, 9.2, and 9.3; ICNU's Adjustments for Pension expense, Incentive Compensation, and Health Care).

120 Staff reviewed and investigated these adjustments.[152] The contested adjustments are those presented by ICNU.[153]

1. ICNU's Pension Expense Adjustment: This adjustment is not a proper *pro forma* adjustment because it is based on speculation, rather than known and measurable changes.

121 ICNU proposes to reduce the Company's pension expense by $944,000 (Washington),[154] based on the assumption that reduced pension costs will result from PacifiCorp's announcement that it plans to alter the Company's pension plans. ICNU therefore reduced pension costs to reflect a two-year historical average, using 2005 and 2006 pension cost levels.[155]

122 ICNU concedes the "ramifications" of any pension plan changes "are undetermined at this time," and that ICNU's adjustment "is not based on any underlying scenario."[156]

---

[150] Schooley, Exh. 321 at 7:17 to 8:2 and Exh. 322 at 15:4-9.
[151] *Id.* For an explanation of each adjustment, see Wrigley, Exh. 131 at 10:21 to 13:11.
[152] Schooley, Exh. 321 at 7:17 to 8:2 and Exh. 322 at 15:12-21.
[153] Company Adjustments 4.4 and 9.2 combine to equal Staff's Adjustment 4.4. The Company's Adjustment 9.3 is the same as Staff's Adjustment 4.10. The $303,027 Staff/Company difference on Adjustment 4.9, "A&G Expense Commitment" (shown in Appendix A at 1, line 19) is a function of the total level of administration and general (A&G) expense. The Company's case contains a level of A&G costs that triggers the adjustment in Commitment Wa 7 from Docket UE-051090. (Commitment Wa 7 is found in Exh. 56 at 24-25). Consequently, Adjustment 4.9 is necessary to implement that Commitment. By contrast, Staff's case contains a level of A&G expenses that is below the threshold that triggers Commitment Wa 7. Because Staff's case does not trigger that A&G adjustment, Staff's case does not include Adjustment 4.9.
[154] Iverson, Exh. 209:6. The NOI effect is $585,877. Exh. 209:9 and Appendix A at 1:23.
[155] Iverson, Exh. 201 at 9:6 to 10:6 and Exh. 209 (Staff assumes the second page "9" is page "10").
[156] *Id.*

These concessions prove ICNU's adjustment is speculative and violates the "known and measurable" standard for a proper *pro forma* adjustment.[157] Moreover, if accepted, ICNU's rationale could backfire because it could be used by PacifiCorp to justify a cost *increase* adjustment based on similar speculation that prices are on the rise. There are also substantial problems with ICNU's calculation.[158]

123 Ratepayers deserve better. The Commission should reject ICNU's pension adjustment.

2. ICNU's Incentive Compensation Adjustment: Staff proposed a similar adjustment in the last case. The Commission rejected it.

124 ICNU proposes a $1.951 million adjustment (Washington) to eliminate 100 percent of executive incentive compensation and 50 percent of non-executive incentive pay.[159] According to ICNU, any incentive pay for executives should come from shareholders, not ratepayers. For non-executives, ICNU points out that part of their incentive is tied to corporate or business performance, and shareholders should therefore bear that cost. Consequently, ICNU proposes to share the non-executive incentive pay 50/50 with ratepayers.[160]

125 Staff is sympathetic with ICNU's adjustment, and Staff likely would have proposed a similar adjustment. However, Staff proposed such an adjustment in the last case, based on more detailed analysis than ICNU now provides. The Commission rejected Staff's adjustment, saying: "the ultimate issue is whether total compensation is reasonable and provides benefits to ratepayers ..."[161]

---

[157] Schooley, Exh. 328 at 8:3-13.
[158] Wilson, Exh. 121 at 9:13 to 10:11.
[159] Iverson, Exh. 211:7. The NOI effect is $1,268,777. Exh. 211:10 and Appendix A at 1:24.
[160] Iverson, Exh. 201 at 10:8 to 11:10.
[161] Schooley, Exh. 328 at 9:20 to 10:8, quoting Commission Order 04 in Docket UE-050684 at ¶ 128.

126 The Commission's framing of this issue makes it difficult for parties to challenge utility incentive pay.[162] Under the Commission's prior order, ICNU cannot sustain this adjustment.

3. ICNU's Health Care Adjustment: This adjustment is not correctly calculated.

127 ICNU proposes to reduce PacifiCorp's health care plan expenses by $269,000 (Washington),[163] on the basis that this reflects the impact of a 22 percent employee contribution level. ICNU claims PacifiCorp's employees contribute roughly 15 percent, while the national average is roughly 22 percent.[164]

128 Staff challenged ICNU's calculation of the 15 percent contribution that ICNU attributes to PacifiCorp employees, because that calculation should have been based on the actual dollars the employees contributed, rather than taking PacifiCorp's total medical plan expense and working backwards.[165] PacifiCorp also criticized ICNU's calculation on the basis that it is based on an outdated and unfairly low level of medical costs.[166] PacifiCorp noted that its current employee contribution levels are in line with utility industry averages, and PacifiCorp is moving to an 80/20 contribution level by 2008.[167]

129 Given the infirmities in ICNU's calculation, the cost trends facing PacifiCorp, and how the Company appears to be managing those trends, ICNU has not proven that any decease to PacifiCorp's test year medical plan expenses is justified.

---

[162] Staff notes that the issue of severance pay was not before the Commission in Docket UE-050684. Accordingly, Staff is proposing a disallowance of certain amounts of severance pay in this docket. *See* ¶¶ 169-90.
[163] Iverson, Exh. 213:5. The NOI effect is $175,019. Exh. 213:8 and Appendix A at 1:25.
[164] Iverson, Exh. 201 at 11:12 to 12:25 and Exh. 213.
[165] Schooley, Exh. 328 at 10:17 to 11:10.
[166] Wilson, Exh. 121 at 8:10-22.
[167] *Id.* at 7:22 to 8:2.

D. Net Power Cost Adjustments (5.1 through 5.6, 9.8, ICNU 5-13).

130 The only contested adjustment between Staff and the Company is Adjustment 5.6, "Water Year Adjustment."[168] Staff contests ICNU Adjustments 6 and 7, but takes no position on ICNU's Adjustments 5,[169] 8, 9 and 11 through 13. ICNU's Adjustment 10 is consistent with Staff Adjustment 5.6.

1. Adjustment 5.6: If the Commission approves a PCAM, it should also accept this adjustment, which removes power supply costs associated with extreme water conditions, which are recovered under the PCAM.

131 When the Commission sets rates in the non-PCAM environment, power costs are established using a normalization procedure, whereby a 40-year average of water conditions is used.[170] This 40-year average reflects a wide range of water conditions, but the procedure for calculating that average is complex and controversial. The PCAM reduces this complexity and controversy.[171]

132 As we described earlier, both Staff and Company-proposed PCAMs are designed to make ratepayers responsible for 90 percent of excess power costs that reach the "outer band." In other words, in times of extreme power cost conditions, ratepayers will be called upon to pay (or get the benefits of) the vast majority of those power costs. Consequently, it is not necessary to include such extreme variations in calculating base power supply costs. The bottom line is that base rates should be consistent with this effect of the PCAM.

133 Staff's Adjustment 5.6 achieves this consistency by removing all extreme water years outside one standard deviation from the mean. Staff used the net power supply

---

[168] Company Adjustment 5.4 and 9.8 combine to equal Staff's Adjustment 5.4.
[169] ICNU classifies its Adjustment 5, "Historical Loss Factors" as an adjustment related to the WCA method. Falkenberg, Exh. 161 at 5, Table 1, line 5. It is more appropriately classified as a test year power cost adjustment.
[170] Buckley, Exh. 261 at 22:9-17.
[171] *Id.* at 23:1-4.

expense related to the remaining years to determine the appropriate normalized base level net power supply expense.[172] Exhibit 264 shows the calculation.

134 PacifiCorp argues that PCAM design and the determination of base net power supply expenses are distinct questions, so the Company opposes Staff's adjustment.[173] Nonetheless, the Company testified that if an adjustment were made to exclude water years, that should be done on a "percentile rank" basis, in order to re-create a new "normal" distribution of water years.[174]

135 PacifiCorp's opposition to this adjustment is not justified. There is nothing wrong with synchronizing the Commission's determination of net power supply costs with the PCAM. The PCAM makes ratepayers accountable for extreme power costs, and that fact should be addressed in the determination of base level power costs.

136 As to the calculation of the adjustment, the Commission should use the actual remaining generation levels, not simply a balance between the numbers of data points created by the Company's calculation. As Mr. Buckley explained: "Any attempt to base a filter on balancing of the number of wet or dry years using a median approach 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."[175]

2. ICNU Adjustment 6: This adjustment improperly removes short-term firm transactions that are essential to service in Washington.

137 ICNU proposes to remove short-term firm transactions from the GRID model in determining net power costs. ICNU offers two justifications: 1) that PacifiCorp included

---

[172] Buckley, Exh. 261 at 23:16-22.
[173] Widmer, Exh. 88 at 8:6-9.
[174] *Id.* at 8:6-18. The Company's approach would yield an adjustment of $0.6 million, compared to Staff's $1.54 million adjustment. *Id.* at 8:13-18 and Buckley, Exh. 264, last line. The NOI effect of these adjustments is shown in Appendix A at 1:32.
[175] Buckley, Exh. 261 at 24:13-16.

only the short-term firm transactions as of the date it filed the case (October 2006), and the transactions appear to be "below market" compared to current prices; and 2) there is no proof these transactions serve Washington.[176]

138 ICNU's adjustment is not well-conceived. As Staff testified, these transactions serve Washington because the Company uses short-term firm transactions to balance its Western control area loads. Consequently, it is appropriate to include these transactions under the WCA method.[177] On the other hand, these transactions will fluctuate over time, and the test year transactions may not be representative. The Commission may wish to require the Company to update its WCA power cost study in a compliance filing, or they can be addressed in the PCAM.[178] However, there is no reason to eliminate these necessary transactions, as ICNU proposes. The Commission should therefore reject ICNU's adjustment.

3. ICNU Adjustment 7: The Commission should not remove the SMUD Contract because ICNU has not shown the contract to be imprudent or that it does not involve the Western control area.

139 This ICNU adjustment relates to PacifiCorp's 1987 contract with the Sacramento Municipal Utility District (SMUD). Currently, PacifiCorp imputes a $37/MWh sales rate on this $18.5 MWh contract, though the Commission has not directly addressed the propriety of that treatment.[179] ICNU proposes to eliminate this contract as not prudent and not "used and useful" to Washington, although ICNU's theories seem to be based on the same analysis.[180]

140 There is no question that market rates today substantially exceed the SMUD contract rate and the imputed rate. However, the test for prudence is based on what the utility knew

[176] Falkenberg, Exh. 161 at 29:5 to 32:18.
[177] Buckley, Exh. 265 at 16:1-6.
[178] *Id.* at 16:6-16.
[179] Falkenberg, Exh. 161 at 34:8-9, at 35:5-6 and at 33:6-8.
[180] *Id.* at 35:13 to 36:4.

or should have known at the time the contract was entered into,[181] and ICNU offers no proof on that issue.[182] Nor did ICNU provide any information indicating that the Western control area had nothing to do with this contract. Staff testified that on this record, the imputed $37/MWh sales price is "a reasonable and appropriate response" to the concerns raised by ICNU regarding this 1987 contract.[183] The Commission should reject ICNU's proposed adjustment.

E. Tax Adjustments (7.1 through 7.10, ICNU Income Tax Expense Adjustment).

141 Staff analyzed each of the Company's tax Adjustments 7.1 through 7.10, and concluded that they were appropriate,[184] except for Adjustment 7.6, "IRS Settlement Amortization." Though the Company did not rebut Staff's testimony calling for the Commission to reject this adjustment on its merits, the Company did not agree to eliminate it.[185]

1. PacifiCorp Adjustment 7.6: The Commission should reject this adjustment because it constitutes retroactive ratemaking. If the Commission decides to accept it, the income that created the additional tax needs to be included.

142 Retroactive ratemaking is generally proscribed.[186] The Commission correctly defines retroactive rate as "surcharges … applied to rates which had been previously paid, constituting an additional charge applied after the service was provided or consumed."[187]

---

[181] Buckley, Exh. 265 at 18:6-13, citing *Wash. Utilities & Transp. Comm'n v. Puget Sound Power & Light Co.*, Dockets UE-920433, UE-920499 & UE-921262, 11th Supplemental Order at 20 (September 21, 1993).
[182] *Id.*
[183] Buckley, Exh. 265 at 19:1-4.
[184] Kermode, Exh. 311 at 5:1 to 9:3. The $398,642 Staff/Company difference on Adjustment 7.1, "Interest True Up" shown in Appendix A, page 2, line 49, is due only to the different rate bases proposed by the Company and Staff.
[185] The Company only agreed that if this adjustment is made, it is appropriate to remove normalized items from the calculation. Wrigley, Exh. 136 at 18:12-16.
[186] *E.g., Town of Norwood v. Fed. Energy Regulatory Comm'n*, 53 F.3d 377, 381 (D.C. Cir. 1995): "The retroactive ratemaking doctrine prohibits the [FERC] from authorizing or requiring a utility to adjust current rates to make up for past errors in projections."

PacifiCorp's Adjustment 7.6 fits this definition to a tee. As Mr. Kermode explained: "The additional income tax expense that the Company has included in this adjustment applies to the period 1991 through 1998. Had the Company recorded the correct amount of tax during that period, there would be no adjustment in this case."[188]

143 Viewed a different way, PacifiCorp is asking the Commission to create a sort of balancing account for federal income taxes, to enable the Company to true-up its prior period taxes after an IRS tax assessment is resolved, without ever seeking an accounting order from the Commission.[189]

144 The costs PacifiCorp incurred in the test year for addressing IRS audits are part of the results of operations.[190] There is no need to violate retroactive ratemaking principles and further burden ratepayers with income tax expenses attributable to prior years. The Commission should reject PacifiCorp Adjustment 7.6.[191]

2. ICNU's Income Tax Expense Adjustment: The Commission should reject this adjustment because it fails to compute taxes based on PacifiCorp's' net income. If the goal is to compute PacifiCorp's share of "taxes actually paid," this adjustment also fails to achieve that goal.

145 ICNU proposes an Income Tax Expense Adjustment that reduces PacifiCorp's federal income tax expense (FIT) by $3.079 million (Washington), through imputation of

---

[187] *Wash. Utilities & Transp. Comm'n v. Puget Sound Energy, Inc.,* Docket UE-010410, Order Denying Petition to Amend Accounting Order (November 9, 2001) at 2. In extraordinary circumstances, the Commission has allowed "rare" exceptions to this principle if required by the public interest, based on sound regulatory principles. *Wash. Utilities & Transp. Comm'n v. Puget Sound Power & Light Co.,* Cause U-81-41, Sixth Supplemental Order (March 12, 1982) at 19; *Wash. Utilities & Transp. Comm'n v. Puget Sound Power & Light Co.,* Dockets UE-920433, UE-920499 and 921262, Eleventh Supplemental Order (September 21, 1993) at 51. As Staff explained, PacifiCorp does not qualify for such extraordinary treatment in this case (Kermode, Exh. 311 at 13:14 to 14:3), and PacifiCorp has not asked for such treatment.
[188] Kermode, Exh. 311 at 11:16-19.
[189] *Id.* at 15:12 to 16:19 and at 13:10-12.
[190] *Id.* at 16:18-19.
[191] In any event, PacifiCorp's adjustment, if accepted, is understated because matching principles require the Company to include the taxable income that gave rise to the taxes the Company now hopes to get ratepayers to pay. *Id.* at 18:12 to 20:11. If the Commission accepts Adjustment 7.6, it must add the matching amount of income, as shown on Exhibit 313.

additional tax deductible interest.[192] ICNU's goal is to "reflect an amount equal to the tax expense likely paid to governmental authorities."[193] ICNU calculates the adjustment by assuming that PacifiCorp's equity is funded in part by MEHC debt,[194] and imputing to PacifiCorp $5.469 million in additional interest associated with this debt.[195] This substantially lowers PacifiCorp's FIT,[196] and ultimately the revenue requirement.[197]

146 ICNU's adjustment should be rejected because it is an unjustified departure from standard regulatory practice, which is to calculate FIT based on the utility's adjusted regulatory income.[198]

147 In any event, it is by no means obvious that ICNU's adjustment benefits ratepayers at all, when the "actual taxes" are accurately calculated. As Staff explained, PacifiCorp does not file a federal income tax return. The Company's ultimate parent, Berkshire Hathaway, files a federal income tax return consolidating all of its subsidiary financial results, including PacifiCorp's.[199] Berkshire Hathaway is a large, highly diversified holding company with assets of $240 billion,[200] and some 500 subsidiaries.[201]

148 This presents a problem for ICNU, because ICNU intentionally avoided calculating PacifiCorp's share of the FIT paid by the "actual taxpayer" here: Berkshire Hathaway.[202] The problem is exacerbated by the fact that if ICNU had accurately calculated PacifiCorp's share of the actual taxes paid by Berkshire Hathaway, the result could be *higher* FIT for

[192] Gorman, Exh. 181 at 3:9 to 10:8 and Exh. 184 at 2:9. This adjustment is shown in Appendix A at 5:12.
[193] *Id.* at 2:2-3. He repeats this goal at 7:11-13.
[194] *Id.* at 3:12-14.
[195] Gorman, Exh. 184 at 3:12.
[196] *Id.* at 1:22.
[197] *Id.* at 2:8.
[198] Kermode, Exh. 314 at 3:9-22.
[199] *Id.* at 2:7-12.
[200] *Id.* at 3:1-5. This figure is as of September 2006.
[201] Evans, Exh. 21 at 4:8-9.
[202] Gorman, Exh. 181 at 4:2-3.

PacifiCorp and its ratepayers, because other companies in the Berkshire Hathaway "corporate tree" pay high mounts of FIT.[203]

149 For these reasons, the Commission should reject ICNU's Income Tax Expense Adjustment.

F. Rate Base (Adjustments 8.1 through 8.17, 9.9).

150 Three contested[204] rate base issues remain:[205] 1) working capital; 2) the ratemaking treatment of the severance benefits PacifiCorp granted to employees who were dismissed after the acquisition of PacifiCorp by Mid-American Energy Holdings Company; and 3) end of period deferred taxes.

1. Working Capital Issues (Adjustments 8.1, 8.3, 8.14, 8.15 and 8.16).

151 In the last rate case, the Commission issued three directives regarding working capital analysis in this case: 1) "the objective is to quantify the amount of working capital and current assets supported by capital on which investors are entitled to a return;" 2) "We expect Staff to support its reliance on the [Investor Supplied Working Capital (ISWC)] approach, particularly if it is true that the ISWC method is used by no other regulators, as the Company asserts;"[206] and 3) All parties are expected to provide "full evidentiary support" for their proposals and methods.[207]

---

[203] Kermode, Exh. 314 at 6:5-15. Ratepayers could also face higher FIT expense in rates in the future if the Commission accepts ICNU's way of calculating FIT, and MEHC simply lowers its debt ratio. Evans, Exh. 21 at 15:1-12.
[204] This statement about "contested" rate base adjustments does not apply to the rate base component of contested O&M adjustments discussed elsewhere in this brief.
[205] The Company's rate base includes three new resource acquisitions: the Eurus Oregon Wind Power project; 2) the Leaning Juniper 1 wind resource; and 3) the contracts that replace PacifiCorp's purchased power agreements with Grant County Public Utility District, associated with the Priest Rapids and Wanapum dams located on the Mid-Columbia. Staff determined these acquisitions were prudent for inclusion in rate base. Buckley, Exh. 261 at 46:20 to 50:20. Public Counsel and ICNU did not address the prudence of these projects.
[206] Order 04 in Docket UE-050684 at 68, ¶ 188.
[207] *Id.* at ¶ 189.

152 As we demonstrate below, Staff complied with these Commission directives, although Mr. Schooley showed that the Company's assertion in the last case was not true: at least three other jurisdictions use a balance sheet approach to determine working capital: Michigan, Florida, and Idaho.[208]

a. Staff's ISWC method explicitly calculates the amount of working capital investors provide.

153 Staff complied with the Commission's first and second directives because, as Staff explained, the investor supplied working capital (ISWC) method is explicitly directed to the measurement of the amount of working capital *that investors provide*.[209] Simply put, the ISWC calculation determines the difference between invested capital and investments. Since investors supply the capital to invest, the excess of invested capital over investments is the amount of working capital investors provide.[210]

154 Using the ISWC method, Staff determined that investors supplied $128.9 million in working capital, total Company, or $8,321,198 for Washington.[211] Staff's Adjustment 8.16, "ISWC" adds this $8.321 million figure to rate base. Because this adjustment calculates the total investor-supplied working capital, Staff removed the Company's proposed working capital amounts.[212]

b. PacifiCorp only assumes its working capital amounts are provided by investors.

155 The Company's working capital adjustment places into rate base several amounts the Company deems to be working capital, which together increase rate base by $16.3

---

[208] Schooley, Exh. 321 at 23:1-4 including footnote 7.
[209] *Id.* at 15:5-16.
[210] *Id.*
[211] Schooley, Exh. 321 at 16:11 to 17:1-13 and Exh. 322 at 14, column 8.16.
[212] Staff reversed PacifiCorp Adjustment 8.1, "Cash Working Capital," and a portion of Adjustment 8.3, "Bridger Mine Rate Base." Staff Adjustments 8.14, "Remove Per Books Working Capital," and 8.15, "Remove Current Assets," remove the other working capital items the Company included. *See* Appendix A.

million.[213] Among these items are prepayments, fuel stock, materials and supplies, and an amount based on the results of a lead lag study.[214]

156 PacifiCorp's working capital presentation fails the Commission's first directive.[215] For example, while the Company includes nearly $7 million worth of "materials and supplies" in its calculation,[216] the Company fails to prove that this amount was supplied by investors. Indeed, in its direct case, the Company said virtually nothing to justify its working capital calculation other than to offer a cursory explanation of the mechanics of its adjustment.[217] In rebuttal, the Company tried to support its case on working capital, relying mostly on a treatise;[218] the same treatise the Company used in the last case to unfairly malign Staff's ISWC method.[219]

157 However, while the Commission asked the parties for evidence, the Company supplied only an assumption that its working capital amounts are supplied by investors. This is clearly evident in the Company's incorrect statement that Staff's ISWC analysis excluded prepayments, materials and supplies and fuel stock from the Company's rate base.[220] In fact, these are material items that make up the investor supplied working capital. Indeed, this is a key advantage of the ISWC approach: it measures how much of those items are contributed by shareholders versus other sources of capital.

158 PacifiCorp then quotes Mr. Hahne's treatise for the point that "... working capital is not a measure of liquidity at a point in time, but the average amount of investment required by investors on a continuing basis over and above that invested in plant and other rate base

---

[213] Schooley, Exh. 321 at 13:18-25. In Exh. 137 at 1, lines 38-41, the same accounts add to $16,195,531.
[214] Schooley, Exh. 321 at 13:18-25.
[215] PacifiCorp did not fail the Commission's second directive because that directive was issued to Staff.
[216] Wrigley, Exh. 137 at 1, line 40.
[217] *See* Wrigley, Exh. 131 at 19:12-22.
[218] Wrigley, Exh. 136 at 17.
[219] Schooley, Exh. 321 at 20:12 to 22:2.
[220] Wrigley, Exh. 136 at 16:21-22.

items."[221] Staff's ISWC calculation does exactly that: it measures the amount of investment over and above the amount that is invested, and that incremental amount is the amount of investor supplied working capital.

159 PacifiCorp again quotes Mr. Hahne's treatise, this time for the proposition that working capital generally consists of fuel inventory, material and supplies inventories, prepayments, and cash working capital.[222] But again, those items are reflected in Staff's ISWC calculation, which determines how much of these items are provided by shareholders.

160 In the end, the Company's approach mostly assumes what working capital is investor-supplied, while Staff's method directly measures that amount.

c. The Company did not fully support its lead lag study.

161 Staff complied with the Commission's third directive by supplying a complete ISWC analysis in Exhibit 323, with all accounts listed. The Company supplied its lead lag study (Exhibit 135), but did not prove it was reliable.

162 First, the Company completed that study in 2003,[223] well before the MEHC acquisition and the impact of the cost savings commitments that came with it.[224] Second, the Company's lead-lag study is based on numerous assumptions, not hard facts.[225] One assumption quite beneficial to the Company is that the date of the check is the date used to measure when the outflow of cash occurred.[226] As we are all aware, any check delivered to a vendor spends some number of days in transit and processing before it actually reduces

---

[221] Wrigley, Exh. 136 at 17:7-10, quoting Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* (2006), Exh. 135 at 6.2.2.
[222] *Id*, at 17:10-12, quoting Hahne's treatise in Exh. 135 at 6.2.2.
[223] Exh. 135 cover sheet.
[224] *E.g.,* Exh. 56, Commitments Wa 2-6.
[225] Schooley, Exh. 321 at 25:6-16. As the Company states in the introduction to the study: "It is the Company's intention to clearly explain every assumption and calculation in its cash working capital study." Exh. 135 at 1.0.2 near the bottom of the page.
[226] Exh. 135 at 4.0.1.

cash balances. The Company admits as much.[227] This assumption increases the net "lag" time, thereby increasing rate base and revenue requirements.

163 Another problem relates to the fact that lead lag studies are very expensive and time consuming, so they are performed infrequently. For example, it takes a Company employee four to five months, working continuously, to complete a study.[228] A consequence is that most of the data in the Company's study is four years out of date,[229] and some data is six years out of date, as shown in the description of the income tax lag.[230]

164 As to other parts of the Company's working capital analysis, the Company directly includes in rate base the current assets, prepayments (mostly insurance premiums and pension payments[231]), fuel stock (primarily coal piles), and materials and supplies (such as poles and wires) to earn a return. Again, while PacifiCorp may assume these items are supported solely by investor supplied capital, the Company has not proven that is so. Only Staff's ISWC approach shows the extent to which these current assets are funded by investors.

d. The Company's lead-lag method and the Company's direct addition of current assets to rate base provide improper incentives.

165 In concept, the lead-lag study measures the difference between the time it takes for customers to pay their bills, and the time between the receipt of goods and the payment for the goods. This time period is multiplied by the average expense per day, and the result is added to rate base. However, this method provides an inherent incentive for the Company to

[227] Wrigley, TR 253:9-12.
[228] Wrigley, TR 254:9-11.
[229] Wrigley, TR 252:5.
[230] Exh. 135 at 4.0.12.
[231] Wrigley, Exh. 134, Tab B15 at 1-2. Of the $2.622 million allocated to Washington, $633,000 is insurance and $947,000 is prepaid pension costs. This represents 60% of the total.

increase the number of "lag" days, which increases rate base and thus increases the dollars of return to the Company.[232] The record is consistent with PacifiCorp acting on this incentive by making payments to vendors sooner than necessary.[233]

166 PacifiCorp's proposal to directly add to rate base the current asset accounts consisting of prepayments, fuel stock, and materials and supplies, provides the Company an additional incentive to maintain higher inventories of these items than necessary.

167 By contrast, Staff's ISWC method provides neither of these improper incentives because it only includes in rate base the invested capital that exceeds the investments. It is this investor-supplied capital that is available to the Company as working capital. By directly measuring how much working capital is supplied by investors, the ISWC method provides incentives for proper fiscal management, *i.e.,* to earn a return on working capital, the utility must show it investors have supplied the funds that provide the working capital.

168 The Commission should accept Staff's ISWC calculation and include $8,321,198 in rate base. The Commission should remove the Company's working capital presentation by rejecting Company Adjustment 8.1, and accepting Staff Adjustments 8.3, 8.14 and 8.15.

2. Adjustment 8.13, MEHC Transition Savings, and PacifiCorp's Accounting Petition in Docket UE-060817.

169 PacifiCorp Adjustment 8.13 goes hand-in-hand with the relief the Company is seeking in the accounting petition the Company filed on May 19, 2006, Docket UE-060817.[234] In that petition, PacifiCorp seeks Commission approval to capitalize and amortize to rates the severance payments and benefits it paid to employees the Company

[232] Wrigley, Exh. 321 at 24:8 to 25:4.
[233] Exh. 324.
[234] Exh. 327 is a copy of the petition.

laid off as a consequence of MEHC's acquisition of PacifiCorp.[235] The Company's Adjustment 8.13 reflects a three-year amortization of these costs.[236]

170 The costs are substantial. By the end of 2006, the Company had dismissed 241 employees, and paid $42,883,385 to do so. Just nine executives account for 36 percent of these dollars; an average severance compensation of $1.66 million per executive. The remaining 232 non-executives got an average of $117,000.[237]

171 The parties propose a wide range of Commission treatment of these costs. At one extreme is PacifiCorp. As we just explained, PacifiCorp wants the Commission to grant its petition, and give the Company dollar for dollar rate recovery over three years of all $42.9 million of these costs,[238] or $14.3 million annually (total company figures). At the other extreme is ICNU, who asks the Commission to deny the petition, and give PacifiCorp zero recovery of these costs,[239] but give ratepayers 100 percent of the cost savings.[240]

172 Located between these extremes is Staff, who recommends that the Commission grant the Company's petition in part, and provide an equitable ratemaking treatment of these costs through a three-year amortization of $25.9 million, or $8.6 million annually (total company figures).[241]

---

[235] Schooley, Exh. 321 at 29:3-19. Originally, the Company also sought to recover a very minor cost ($400,000, total company) for software changes to accommodate the Company's decision to change its fiscal year. Schooley, Exh. 321 at 39:10-17. On rebuttal, the Company agreed to remove this amount from its request. Wrigley, Exh. 136 at 11:11-12.
[236] Wrigley, Exh. 131 at 22:6-18.
[237] Schooley, Exh. 321 at 31:5-13.
[238] The Company acknowledged this updated figure in its rebuttal testimony. Exh. 136 at 7:19 to 8:1.
[239] Iverson, Exh. 201 at 2:12-17 and at 3:18 to 8:23.
[240] As Mr. Schooley explained, ICNU's use of $15.295 million in transition costs (Iverson, Exh. 203 at 3, "ICNU" column) is in error because that figure includes severance pay associated with events other than the MEHC acquisition. ICNU should have used $11.928 million as the starting point. Schooley, Exh. 328 at 4:6-21 and Wrigley, Exh. 136 at 9:10-18.
[241] Schooley, Exh. 321 at 27:3 to 28:5 and Exh. 325, lines 16 and 19.

a. The Commission should permit the Company to recover some level of transition costs from ratepayers.

173 The threshold issue is whether PacifiCorp should recover any of these transition costs from ratepayers. Staff testified that this type of cost should be eligible for recovery through rates. As Staff explained, there are future benefits associated with these severance costs, by way of lower future operating costs. For a regulated company like PacifiCorp, it is fair to amortize the expense to more properly match these benefits.[242]

174 ICNU's proposal contradicts this matching analysis because ICNU wants to take all the savings of the severance program, and allow PacifiCorp to recover none of the costs the Company incurred to achieve those savings.[243]

175 The Commission has approved amortizations to match costs and benefits in these and other circumstances, such as the costs of vegetation management programs and the transition costs associated with the earlier acquisition of PacifiCorp by Scottish Power.[244] The Commission should approve an amortization in this case, so long as the amortization amount is correctly calculated.[245]

b. The Commission should deny deferral and rate recovery of all transition costs PacifiCorp booked before May 2006.

176 The Company needs Commission permission before it may capitalize and amortize these severance costs. Without Commission approval, the Company would have to expense these transition costs in the period the costs were incurred. When the MEHC acquisition of

---

[242] Schooley, Exh. 321 at 32:4-13.

[243] Schooley, Exh. 328 at 3:1-10.

[244] *In re Petition of Puget Sound Energy, Inc.,* Docket UE-980877, Order Authorizing Accounting Treatment (July 8, 1988), *In re Petition of Pacific Power & Light, d/b/a PacifiCorp*, Docket UE-000969, Order Granting Request to Defer Early Retirement and Severance Program Costs (August 30, 2000).

[245] In this regard, Staff's calculation meets each of ICNU's recommendations if an amortization is approved, except as Staff explained, a three year amortization is better for ratepayers than ICNU's proposed five-year amortization, and ICNU's recommendation for a future study is unnecessary because the evidence to support such a study is contained in this docket. Schooley, Exh. 328 at 5:16 to 7:6.

PacifiCorp was finalized in March 2006, PacifiCorp immediately began to lay off employees.[246] However, the Company delayed until May 19, 2006, before seeking Commission approval to defer and amortize these costs.[247]

177 Commission rules expressly require utilities to follow the Uniform System of Accounts and seek approval for any deviations from that system.[248] The Commission is serious about this requirement. As the Commission stated in Docket UE-921262:

> The Commission orders [Puget Sound Power & Light Company] to immediately cease creating unauthorized deferral accounts. If the company believes it has cause for creating a reserve deficit, it is well aware of its obligation to petition the Commission for an accounting order authorizing such action.[249]

178 PacifiCorp presented virtually the same timing issue in Docket UE-020417. In that case, the Commission ruled that "authorizing deferral accounting, in appropriate circumstances, *for costs incurred during periods that post-date an application* to establish such accounting does not violate the general prohibition against retroactive ratemaking."[250]

179 The Commission can excuse an untimely accounting petition in extraordinary circumstances outside the utility's control.[251] However, no such circumstances exist here. PacifiCorp's severance program has been in place since 1998, well before the MEHC acquisition.[252] PacifiCorp implemented that program in March 2006 by expensing severance costs on its books at the time each employee was notified of his or her

---

[246] Schooley, Exh. 321 at 33:6-8.
[247] *Id.* at 28:14.
[248] WAC 480-100-203(3).
[249] *Wash. Utilities & Transp. Comm'n v. Puget Sound Power & Light Co.,* Docket UE-921262, 11th Supplemental Order at 53 (September 21, 1993).
[250] *Wash. Utilities & Transp. Comm'n v. PacifiCorp, dba Pacific Power & Light Co.,* Docket UE-020417, 3rd Supplemental Order (September 27, 2002) at 2, ¶ 6 (emphasis supplied). The Commission's treatment is consistent with the general rule: "A utility may not commence the deferral and amortization of a cost by establishing a reserve and expect to recover the amortized cost in rates, unless it has requested a deferral and amortization from the commission in advance. If the company goes forward and establishes an unauthorized reserve, the commission usually will not approve retroactive deferral of such costs." Leonard Saul Goodman, *The Process of Ratemaking* (1998) at 322.
[251] Schooley, Exh. 321 at 35:4-17.
[252] Wilson, Exh. 126.

termination.[253] There can be no doubt that PacifiCorp was well aware of its own severance program, and its obligation to seek an accounting order.

180 Consequently, the Commission should not permit PacifiCorp to recover from ratepayers the transition costs it expensed before May 2006. The Commission should remove $13.593 million PacifiCorp of the system-wide amount of transition costs PacifiCorp recorded before then.[254]

c. The Commission should limit executive severance benefits to the same percentage of pay that non-executives received.

181 The next issue is whether ratepayers should be required to pay an average $1.66 million for each executive PacifiCorp laid off. Staff proposed a more equitable sharing of this sizeable amount, by calculating the recoverable executive severance amount at same average level for non-executives, or 88 percent of their pay level. This reduces the deferral by about $3.4 million (system-wide).[255]

182 PacifiCorp waited until rebuttal to justify its proposed level of executive severance compensation. The Company's rationale is that the market for executives is competitive, and the Company needs to offer large severance payments to its executives in order to attract them, maintain them, and motivate them. The Company also complains that Staff's analysis constitutes "micromanagement" of the Company.[256]

183 There are several problems with the Company's rationale. First, it is hard to believe that executives, who are paid hundreds of thousands of dollars annually, including

---

[253] Wrigley, TR 247:20 to 248:4.
[254] This amount is favorable to the Company because it does not remove the severance costs PacifiCorp recorded between May 1, 1006, and May 19, 2006, the date the Company filed its accounting petition. Schooley, Exh. 321 at 37:18-23.
[255] Schooley, Exh. 321 at 37:5-16.
[256] Wilson, Exh. 121 at 11:20 to 12:4 and TR 231:12-14.

substantial automobile allowances and other perquisites, need millions more in severance benefits to remain at PacifiCorp and be "motivated."

184 Second, these severance packages reflect a disturbing circularity of action, because if each company justifies its severance packages the same way as PacifiCorp, this creates an upward spiral effect on severance pay. The Company fully enables this phenomenon by failing to reduce an executive's salary when the market is less competitive for those services,[257] and by allowing many of the same employees who benefit from PacifiCorp's severance programs to play a role in developing or approving those programs.[258]

185 Third, the Company's "competitive market for executives" rationale is contradicted by Company testimony that its executives need a long time to find another job.[259] In other words, if the market for executives is competitive, as PacifiCorp claims, why must the Company offer a *minimum* of one full year of outplacement services, including help writing a resume, help in interviewing, and "modeling an interview process?"[260]

186 Plainly, without Commission action, ratepayers lack effective protection from these programs. The issue is not "micromanagement." The issue is fairness. What amount of severance costs should shareholders absorb, and what mount should ratepayers pay in rates? Staff's adjustment strikes an appropriate balance, and the Commission should reduce the transition cost deferral by $3.4 million consistent with Staff's recommendations.

d. Staff's transition cost adjustment is not affected by Commitment Wa 7a.

187 On rebuttal, PacifiCorp argued that Staff's removal of the severance costs PacifiCorp booked before May 2006 is an improper matching. The Company notes that under

[257] Wilson, TR 236:23 to 237:4.
[258] Wilson, TR 238:20-24.
[259] *Id.* at 12:9-11.
[260] Wilson, TR 235:15-21.

Commitment Wa 7 in Docket UE-051090, and effective April 2006, Washington ratepayers began to receive a monthly credit for A&G benefits. PacifiCorp says it is not fair to remove severance costs the Company incurred in April 2006 because they helped gain those benefits.[261]

188 The Company's reliance on Commitment Wa 7a in Docket UE-051090 is misplaced. First, that Commitment does not address ratemaking, nor does it tie the Company's obligation to pass through a specific level of cost savings with rate recovery of the costs of the Company's severance programs. That Commitment does not waive the requirement that PacifiCorp must file for Commission approval before it capitalizes severance costs, rather then wait until well after it has expensed a substantial amount of these costs. Indeed, if PacifiCorp wanted to bind the Commission on how to treat severance costs for ratemaking purposes, it should have obtained a commitment addressing that point.

189 Commission rules set forth the requirement for filing an accounting petition, and the Commission has enforced that requirement in other cases. However, the Commission does not control when PacifiCorp elects to make such a filing. The Commission should not blindly apply the matching concept to excuse the Company's non-compliance, and pretend the Company filed its petition earlier than it did.

e. Recommendations.

190 For the reasons stated above, the Commission should accept Staff's Adjustment 8.13. The Commission should grant the Company's petition in Docket UE-060817 in part, and accept Staff's recommended conditions which are set forth in Exhibit 321, pages 27 and 28.

---

[261] Wrigley, Exh. 136 at 10:2-20.

3. End of period deferred taxes.

191 In the 1985 PacifiCorp rate case, the Commission applied its policy of calculating rate base using end of period deferred tax balances, while other rate base mounts are calculated using average of monthly averages balances. The Commission explained that the intent of the policy is to match, as closely as the law permits, ratemaking taxes with taxes calculated using accelerated depreciation.[262] The Commission rejected PacifiCorp's argument that this treatment violated the Internal Revenue Code and jeopardized the Company's ability to take the benefit of accelerated depreciation on its tax return.[263]

192 Fast forwarding to the present, PacifiCorp's rebuttal case replaced the end of year deferred tax balance in rate base with an average of monthly averages balance. Once again, the Company says this is required by the Internal Revenue Code. This time, the Company's basis is a private letter ruling issued to another utility by the Internal Revenue Service.[264]

193 PacifiCorp's use of this private letter ruling is improper as a matter of law, because federal law prohibits private letter rulings from being used or cited as precedent.[265] Nonetheless, in this case the difference between end of period and average balances of deferred taxes is immaterial.[266] Consequently, Staff does not object to the use of average balances of deferred taxes, for this case only.

---

[262] *Wash. Utilities & Transp. Comm'n v. Pac. Power & Light Co.,* Cause U-84-65, 3rd Supplemental Order (August 2, 1985) at 19-24,
[263] *Id.* at 21, 4th new ¶.
[264] Wrigley, Exh. 136 at 22:3-14.
[265] 26 U.S.C. § 6110(k)(3).
[266] Exh. 137 at 45.

V. REVENUE ALLOCATION AND RATE DESIGN

194 The only contested revenue allocation and rate design issue is the appropriate rate for low income bill assistance.

A. Uncontested Proposals.

195 PacifiCorp proposes to apply a uniform percentage increase to the residential class, Schedule 48T, Large General Service, and Schedule 40, Agricultural Pumping Service. Schedule 24, Small general Service, would get 75 percent of the average increase, and Schedule 36, Large General Service, would get the overall average increase.[267]

196 The Commission should accept this revenue allocation proposal for purposes of this case. It is the same allocation the parties agreed to in the last case, in a settlement of revenue allocation and rate design issues. All other parties taking a position on this issue in this case agree it is appropriate, if the Commission finds a revenue deficiency.[268]

197 The Commission should also accept the Company's proposal to delete certain obsolete tariff pages under which no customers are served,[269] and the Company's proposal to implement Schedule 95, which is the A&G credit called for under Commitment Wa 7a from the MEHC/PacifiCorp transaction.[270]

B. The Commission Should Increase The Schedule 91 Low Income Bill Assistance Program Rates By 21.2 Percent On Average.

198 The Low Income Bill Assistance Program (LIBA) is 100 percent ratepayer funded. PacifiCorp collects the money via a surcharge in Schedule 91, and the money is used to assist low income customers in paying their bills via a credit offered in Schedule 17.

---

[267] Griffith, Exh. 31 at 11:1-10.
[268] Staff: Schooley, Exh. 321 at 44:13-17; ICNU: Iverson, Exh. 201C at 13:1-18.
[269] Griffith, Exh. 31 at 19:1-17.
[270] Griffith, Exh. 45 at 3:14 to 4:2 and Exh. 48.

199 Initially, PacifiCorp proposed to increase the Schedule 91 tariff by the same percentage as the Company's proposed increase to the residential rate, resulting in Schedule 91 collecting about 0.29 percent of revenues.[271] The Energy Project recommended that the LIBA surcharge be increased "at least to a level in the range of that provided by Avista [0.41 percent of revenues] and PSE [0.64 percent of revenues] ..."[272] On rebuttal, PacifiCorp left it to the Commission to choose among these three funding levels.[273]

200 The Commission should accept PacifiCorp's original proposal: an increase in the Schedule 91 LIBA rates to collect about 0.29 percent of revenues. There is no cogent reason why PacifiCorp must be "in the range" of Avista and PSE's funding levels, as The Energy Project proposes. For example, Avista's program funding level was established in an uncontested tariff filing,[274] and has evolved as part of settlement negotiations.[275] Staff also notes that in the MEHC acquisition docket, PacifiCorp committed to a contribution of $80,000 per year for five years; a 14 percent increase from the previous funding level [276]

201 On balance, Staff recommends the Commission approve the monthly charges in Schedule 91 to the specific dollar levels identified in Exhibit 47, column 2. This rate will maintain the surcharge at a percentage amount equal to or greater than the total percentage of all residential base price increases, from the time the program was implemented.[277]

---

[271] Griffith, Exh. 31 at 19:19 to 20:9 and Exh. 45 at 2:7-10.
[272] Eberdt, Exh. 231 at 6:1-8; the percentages for Avista and PSE are shown at 4:21-23. PacifiCorp's percentage is shown in Mr. Griffith's testimony, Exh. 45 at 2:7-10 and at Exh. 46.
[273] Griffith, Exh. 45 at 3:9-13.
[274] Docket UE-010436. The tariff was effective May 2, 2001.
[275] *Wash. Utilities & Transp. Comm'n v. Avista Corp.*, Dockets UE-050482 & UG-050483, Order 05 (December 21, 2005).
[276] *In re Application of MidAmerican Energy Holding Co. and PacifiCorp*, Docket UE-051090, Order 07 at 9, ¶25 (February 22, 2006).
[277] Staff understands the actual disbursement of the additional funds through Schedule 17 will be accomplished after collaborative discussions between the Company and interested parties.

VI. CONCLUSIONS

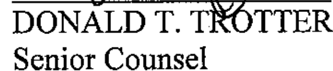
202 In Docket UE-061546, the Commission should accept the WCA allocation methodology, order PacifiCorp to file tariffs to implement Staff's proposed PCAM, and allow the Company to file tariff revisions that increase its revenues no more that 5.4 percent, based on a revenue deficiency of $12,324,910, and using the revenue allocation and rate design to which the parties have agreed. The Commission should also approve the Company's proposed A&G credit tariff (Schedule 95), and require that tariff to go into effect on the same date as the tariffs implementing the general rate increase. The Schedule 91 Low Income Bill Assistance tariff should be increased by an average of 21.2 percent to equal the rates identified in Exhibit 47, column 2.

203 In Docket UE-060817, the Commission should grant the Company's petition in part, subject to the conditions listed in Staff Exhibit 321, pages 27 and 28.

DATED this 23rd day of April, 2007.

Respectfully Submitted,

ROB MCKENNA
Attorney General



DONALD T. TROTTER
Senior Counsel

Counsel for the Washington Utilities and Transportation Commission Staff