BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. PACIFICORP d/b/a PACIFIC POWER & LIGHT COMPANY Respondent.	DOCKET NO. UE-032065

INITIAL BRIEF OF PUBLIC COUNSEL

OCTOBER 8, 2004

I. INTRODUCTION

1. The Public Counsel Section of the Washington State Attorney General's Office (Public Counsel) respectfully requests that the Washington State Utilities and Transportation Commission (Commission or WUTC) reject the settlement proposal presented by the Commission's Staff (Commission Staff or Staff), the National Resource Defense Council (NRDC), and PacifiCorp d/b/a Pacific Power & Light Company (PacifiCorp or company) and enforce the rate plan pursuant to the last settlement this company put before the Commission in Docket No. UE-991832.

II. ARGUMENT

2. It is Public Counsel's position that the proposed settlement now before the Commission, as well as the company's case in chief, violates the Rate Plan agreed to in 2000 and should be rejected on that basis. Public Counsel further asserts that even if the Commission disregards the 2000 Rate Plan and considers this settlement, the proposed settlement is not in the public interest as it fails to address the concerns raised by the Commission in the order which broke the Rate Plan and allowed this rate case to be filed – most critically inter-state cost allocation, the prudence of new resources, and cost of capital.[1] Further, the proposed settlement is not supported by the record. For these reasons Public Counsel recommends that that proposed settlement be rejected and a prehearing conference set to re-establish a litigation procedural schedule.

[1] Exhibit 450; Transcript (Tr.) 336, 534-35, 731.

A. The Settlement and the Rate Case violate the Rate Plan.

3. In 2000 the Commission approved a settlement for PacifiCorp and the Rate Plan it contained.[2] That settlement established a Rate Plan for PacifiCorp where the company would receive a rate increase in each of the first three years of the Rate Plan, but there would be no increases in the fourth and fifth years (2001-3%, 2002-3%, 2003-1%, 2004-0%, & 2005-0%). PacifiCorp explicitly agreed that it would not seek to increase rates during the five-year period of the Rate Plan.

4. As the Commission is aware, the 2000 Rate Plan would have allowed PacifiCorp to file a general rate case in early 2005 with new rates coming into effect no earlier than January 1, 2006. It is Public Counsel's position that the current proceeding, including the proposed settlement, should be rejected by the Commission as inconsistent with the Rate Plan. All subsequent advocacy in this brief is based upon this premise. However, in order to more fully develop the issues before the Commission should the Commission consider the settlement, Public Counsel has addressed an array of factual and legal issues implicated by the proposed settlement which, in Public Counsel's view, makes the proposed settlement contrary to the public interest. The fact that Public Counsel has done so should not be interpreted as conceding its primary advocacy or changing its position regarding the matters now before the Commission and the courts.

B. The Settlement is not in the Public Interest.

5. The proposed settlement presented by the Commission Staff and PacifiCorp is not in the public interest due to its failure to resolve the most critical issues in this proceeding, including inter-state allocation, prudency of resource acquisitions, and financial accountability (i.e. establishing financial baselines such as cost of capital and capital structure). The proposed

[2] The *Third Supplemental Order Approving and Adopting Settlement Agreements; Rejecting Tariff Sheets; Authorizing and Requiring Compliance Filing* in Commission Docket No. UE-991832, 204 P.U.R.4th 155 (August 9, 2000).

settlement is not in the public interest as the record fails to allow the Commission to determine that the resulting rates are fair, just, reasonable, and sufficient. The settling parties fail to provide sufficient evidence to support the proposed settlement in several additional, crucial areas. The use of the original and revised protocols have insufficient evidentiary support for their use to resolve this proceeding. There is also insufficient evidence to support the so-called "Public Counsel Adjustments" or deferral of the Trail Mountain Mine and environmental remediation costs as requested in the settlement.[3] The settlement now being proposed by the company and Commission Staff is unsupported by the record in these crucial respects and the Commission should reject it upon that basis.

6. As discussed during cross-examination, even the revised protocol is not a clearly-established, monolithic document. There are variations under consideration or already in place on a state-by-state basis including the rate caps in Utah that cap rates based upon the difference between the rolled-in method and the revised protocol.[4] Ms. Kelly testified that the company has committed in Utah that the company will bear any shortfall associated with the Utah rate caps.[5] Unfortunately, shortfalls in one jurisdiction create incentives to seek recovery in other jurisdictions. The company has arguably sought to put in place in Utah precisely the same set of structural "tensions" that created the current allocation crisis; i.e. Utah's moving early to a fully rolled-in methodology (which the company did not contest). Creating circumstances where Utah may not end up bearing the costs associated with its growth is not a reasonable, let alone permanent solution.

7. Public Counsel's recommendation if the Commission rejects the proposed settlement and proceeds with this case is the adoption of the situs methodology advocated by Mr. Lazar to address interstate cost allocation issues. Doing so would provide the greatest benefit to

[3] As Mr. Schoenbeck recommends, trail mountain mine and environmental remediation should be left in their own dockets for full investigation by all parties, and resolution by the Commission. Tr. 135.

[4] Tr. 671.

[5] Tr. 672; Exhibit 79.

Washington ratepayers through a rate decrease at the time the Rate Plan expires.[6] As testified to by Mr. Lazar, the use of his "situs allocation" methodology would produce the best outcome for PacifiCorp's Washington ratepayers.[7] Application of the situs methodology could produce between a $34.3 and a $24.6 million rate decrease for Washington ratepayers.[8] Use of Mr. Lazar's situs allocation methodology would be in the public interest in the 2005 rate case contemplated by the Rate Plan.

1. The Settlement does not comport with the Commission's 6th/8th Order.

8. In the Commission's final order in the deferral docket (6th/8th Order) the Commission identified a number of issues as the basis for denying the requested deferral, and allowing this rate case. These included: 1) the lack of an allocation methodology, 2) the lack of a determination regarding the prudence of certain resources, and 3) the lack of financial accountability (establishment of financial baselines).[9] Included in the concerns expressed by the Commission in the 6th/8th Order were a restatement of the concerns expressed earlier by the Commission when it approved the last settlement in 2000. The concerns expressed then included the lack of a definite capital structure.[10] The settlement that the company and Commission Staff now urge the Commission to approve fails to address the most significant elements of the Commission's concerns expressed in the 6th/8th Order, and attempts to garb a "black box" settlement in a diaphanously thin cloak of respectability.[11] Given the lack of specific evidence supporting the individual provisions of the proposed settlement, as well as the settling parties' refusal to state how the numbers were reached, there is no practical difference between this settlement and the typical single revenue requirement black box settlement.[12] The settling parties

[6] Exhibits 501, 512, 513.
[7] Exhibits 501, 512, 513.
[8] Exhibit 522.
[9] Exhibit 450 at ¶¶ 26, 30, 42, 57.
[10] *Id.* at fn. 16.
[11] Tr. 401-2, 449-50.
[12] Exhibits 8-11, Tr. 387.

fail in every significant respect to answer the very questions posed in the 6th/8th Order and the settlement should be rejected on this basis for the reasons set forth below.

a. Allocation is not resolved.

9. PacifiCorp is a multistate utility that operates its system on a unified basis, separated into Eastern and Western control areas.[13] As such it has sought for over 20 years to develop an allocation methodology which all of its state jurisdictions would support.[14] The latest settlement's most singular failure is its failure to resolve this critical issue.[15] The settling parties urge the Commission to accept the original protocol for purposes of this case (and no other) and to allow the company to base all future reports to the Commission on the revised protocol.[16] The settling parties frankly acknowledge that the original protocol is not a solution to the allocation problem.[17] As a result, this settlement fails to resolve the most significant issue in this rate case.[18]

10. As company witness Furman admitted upon cross-examination, the Commission wanted allocation issues resolved in a general rate case and that is one of the reasons he believes the Commission allowed the company to file this case.[19] Now the company and the Commission Staff propose what can best be characterized as a "placeholder" for resolving inter-state cost allocation issues.[20] It is clear that if the Commission accepts this settlement proposal the Commission will be faced with another general rate case in 2005 that will again seek approval of a multi-state allocation scheme. The Commission and the parties to that proceeding will be faced

[13] Exhibit 581 at 32.
[14] Tr. 674-76.
[15] Tr. 329, 366.
[16] Exhibit 3 at 3-4.
[17] Tr. 373.
[18] Exhibit 450 at ¶¶ 30-31.
[19] Tr. 205.

with once again litigating an allocation methodology that may or may not be consistent with the methodologies proposed by the company in its other jurisdictions.

11. As a multi-state utility PacifiCorp is inherently at risk that different states will take divergent approaches to issues such as power cost allocation. PacifiCorp's Washington state ratepayers have no legal obligation to pay increased rates in order to cover costs associated with load growth in other states. The merger of the old Utah Power and Pacific Power systems and the subsequent merger with Scottish Power were transactions undertaken by knowledgeable parties who knew the risks involved. Company representatives repeatedly assured the Commission at the time of the two mergers that Washington ratepayers would not be harmed. Now that such harm has allegedly materialized the company is no longer willing to stand behind those assurances.[21]

12. The original protocol has been discredited by every party to this proceeding, including PacifiCorp.[22] PacifiCorp was the only proponent of the original protocol methodology up until the filing of the proposed settlement. With the filing of the company's rebuttal testimony it became clear that the original protocol filed as part of its direct case was no longer the methodology the company was propounding in its other jurisdictions.[23] As described by Staff witness Buckley, the failure of PacifiCorp to seek to import the revised protocol earlier in the proceeding eliminated other parties' ability to critically examine it.[24] The original protocol is not a valid methodology for purposes of reaching a settlement and indisputably is not a valid methodology for application by this Commission.

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[20] Tr. 199.
[21] Exhibit 501 at 4-6; Tr. 396, 441.
[22] Tr. 222.
[23] Exhibits 73-80.

13. The proposed settlement's reliance upon the revised protocol for reporting purposes is similarly flawed.[25] The revised protocol has not been subject to critical examination by any party in Washington, with the partial exception of Industrial Customers of Northwest Utilities (ICNU) which have examined it only in the context of the company's Oregon proceedings in which ICNU is a party.[26] It also has significant differences from the original protocol.[27] It would be inappropriate for the Commission to adopt the settlement and allow reporting based upon an allocation methodology that its own staff could not support for all purposes.

b. Prudence is not resolved.

14. The proposed settlement also fails to resolve prudency issues around Eastern Control Area resources that were left unresolved in the settlement of the company's last general rate case in Washington state.[28] This was an area of concern for the Commission in 2000 and again in

[24] Exhibit 581 at 98-104.
[25] Exhibit 3 at 3-4.
[26] Tr.660.
[27] Tr. 203-4.
[28] Exhibit 3 at 6 and 15; Tr. 338.

2003. Yet the settling parties propose to defer the matter yet again, four years later. [29]

15. The proposed settlement either fails to address the Commission's concerns, or blithely requests that the resources be recognized in rates. Section 12(d) of the proposed settlement appears to promote the recovery of all other company adjustments.[30] This "carte blanche" is disturbing given that the Commission Staff, by its own admission, did not examine the prudency of assets and liabilities associated with the Eastern Control Area.[31] Commission Staff is therefore recommending to the Commission the recovery in rates of assets and liabilities which are unexamined.

c. Accountability and establishment of financial baselines is not resolved.

16. As noted above, one of the Commission's other concerns in the 6th/8th Order was financial accountability. The Commission expressed that this concern has been in place since the approval of the Rate Plan in 2000. A significant element of this concern is the lack of established financial benchmarks that would allow the Commission to "achieve a thorough and comprehensive understanding of PacifiCorp's financial circumstances…"[32] The settlement proposal now before the Commission fails to satisfy these concerns by providing the bare minimum amount of information around the periphery of what is in fact a "black box" settlement. The settlement provides a revenue requirement of $15.5 million, an alleged overall rate of return of 8.39%, and provides as support for these two figures only the revenue requirement adjustments and power cost adjustments identified on Attachments A and B to the

[29] Exhibit 450 at ¶ 26.
[30] Exhibit 3 at 8.
[31] Tr. 739.
[32] Exhibit 450 at ¶ 42.

Settlement.[33] The settlement fails to provide the Commission with an explicit capital structure, a return on equity, or any of the other elements fundamental to satisfying this Commission's previously expressed concerns. Public Counsel's specific concerns regarding the settlement's implied capital structure are discussed in greater detail below.

2. Use of the Original and Revised Protocol by the Settlement is not in the Public Interest.

17. The company relied upon the original protocol when it filed its direct case.[34] The record now before the Commission is clear that since that time the company itself has moved away from the original protocol in its other jurisdictions and is in fact currently advocating the adoption of the revised protocol in the rest of its jurisdictions.[35] The settlement now before the Commission proposes to use the original protocol for resolution of this docket. The asserted justification for doing so is that it is the "only common basis upon which the parties [Staff and PacifiCorp] could evaluate each other's proposed adjustments."[36] This is an assertion that deserves closer examination by the Commission.

18. Despite the settling parties' assertions, it is clear from the record that the revised protocol is a basis upon which the Commission Staff and PacifiCorp could have examined each other's adjustments; they simply could not have done so in a single day, in a settlement conversation that excluded all other parties. The original protocol is not "guided by principles of cost and benefit

[33] Exhibit 3 at 5.
[34] Exhibits 71, 72.
[35] Exhibits 73-75; Tr. 141.
[36] Exhibit 3 at 3.

causation, fairness and equity."[37] It also does not "facilitate the ability of this Commission to determine the appropriate power supply and transmission costs related to serving Washington."[38]

19. Any attempt to use the original protocol as the basis for the settlement is flawed since doing so requires examining the company's entire system.[39] By their own admission, the Commission Staff's own analysis ignored the Eastern control area. The totality of the evidence in the record before the Commission is clear that the original protocol is not a reasoned basis for resolving this proceeding and the Commission should reject the settlement on this basis.

20. Mr. Lazar testified that the use of the original protocol by the settlement is not in the public interest as it fails to meet the no-harm standard previously agreed to by the company and applied by the Commission.[40] As the Chairwoman and Administrative Law Judge Moss identified, there is also a risk that approving the settlement and its non-resolution of allocation creates an incentive for the company not to resolve allocation issues in Washington so long as this settlement provides the company with returns it considers acceptable.[41] The company's conduct from 1986 onward substantiates this concern.

21. The Commission Staff could have chosen to look at the revised protocol as a basis for commonality and consensus, but doing so would in all probability have required the company to extend the suspension period for this proceeding, something the company has committed to do only reluctantly, and only in the context of this settlement proposal.[42] The revised protocol could

[37] Exhibit 581 at 55.
[38] *Id.* at 68.
[39] Tr. 547-48.
[40] Tr. 396-97.
[41] Tr. 501, 650-51.
[42] Tr. 75-81, 540.

easily have been the basis for all parties' analysis of the rate case now before the Commission but the company chose to file its case based upon an out-dated protocol even at the time it was filed in Washington. This left the other parties in the difficult position of trying to respond to a significantly different protocol that was then, as predicted by Mr. Buckley, filed in the company's rebuttal case.[43]

22. Commission Staff witness Buckley pointed out that the benefits do not follow the costs in the revised protocol.[44] This is born out by Ms. Kelly's refusal to discuss benefits in her deposition.[45] Mr. Falkenberg testified that the original protocol is the worst of all methods under consideration for Washington ratepayers.[46] He believes that the revised protocol is measurably better than the original and could be improved further.[47]

23. Whether the revised protocol is a reasonable and appropriate basis for determining the interstate allocation of power costs is not something that can be determined by this Commission due to the lack of evidence now in the record.

24. The settlement now before the Commission proposes to use the revised protocol on a going forward basis for reporting purposes.[48] This is the case despite the testimony of Mr. Braden and Mr. Buckley which made it clear that the Commission Staff's hybrid approach ignored the Eastern control area all together, along with associated costs and therefore the Staff never analyzed the revised protocol.[49] Since the company filed the revised protocol in its

[43] Exhibit 581 at 98-104
[44] Tr. 773; Exhibit 581 at 55.
[45] Exhibit 77 at 75.
[46] Tr. 537.
[47] Tr. 538.
[48] Exhibit 3 at 4.
[49] Tr. 340; Exhibit 581 at 98-104.

rebuttal case, other parties had only a limited opportunity to examine it. As Mr. Buckley said, this is "highly prejudicial to the Commission and the responding parties."[50]

25. It should be noted that the company and the Commission Staff are far apart on the proper resolution of allocation.[51] Mr. Braden acknowledges this as a "potential" problem.[52] Despite the settlement, there already appears to be some disagreement between the company and Staff on the scope of the use of the revised protocol under the settlement given Mr. Galloway's recent statements in Oregon.[53] Given these inherent uncertainties the proposed settlement is not in the public interest. By March of 2005 the company will have a degree of certainty regarding the fate of the revised protocol in Utah and Oregon, which would significantly contribute to a more productive consideration of inter-state cost allocation issues here in Washington.[54]

26. There is insufficient evidence in the record now before the Commission to support even this limited use of the revised protocol. It has not been "tested" by the adversarial process due to the company's choice of filing it in its rebuttal case. It may be that the revised protocol is better than the original protocol for Washington state ratepayers as Mr. Falkenberg and Mr. Furman testified.[55] Unfortunately, this Commission has no way of knowing if this is true. More disturbingly, given Commission Staff's testimony in this proceeding, it appears there is no way for them to have known at the time they entered into the present settlement what the impact on Washington would be of the revised protocol. This is due to the lack of an adequate analysis of

[50] *Id.*
[51] Tr. 626.
[52] Tr. 647.
[53] Exhibit 12 at 20; Tr. 377.
[54] Tr. 238-39, 495-96, 780-81.
[55] Tr. 206, 499-500, 538; Exhibit 32 at 7.

the revised protocol by Commission Staff and their asserted inability to examine their own case in light of the revised protocol.[56] Use of the original and revised protocols as set forth in the proposed settlement is not in the public interest.[57]

3. No evidence supporting the proposed settlement's identification of "ICNU/PC adjustments."

27. The Commission should disregard the identification by the settling parties of "working capital," "IRS Settlement adjustments," and "Unspecified ICNU/Public Counsel adjustments."[58] As admitted by Mr. Braden during cross-examination, and substantiated by the settlement document itself, there is nothing that identifies what is represented by these claimed adjustments other than their titles.[59] There is no evidence in the record that these adjustments in fact relate in any way to the adjustments proposed by Mr. Dittmer or ICNU witnesses; as opposed to those sponsored by Commission Staff or some other party. For this reason the Commission should disregard the implied assertion that these adjustments reflect amounts attributable to the adjustments sponsored by Mr. Dittmer or ICNU witnesses.

28. The Settlement proposal now before the Commission identifies in Attachments A "cash working capital," "IRS Settlement," and "Unspecified ICNU/Public Counsel Adjustments" as three categories of adjustments the settling parties identify as associated with Public Counsel.[60] While it is correct that Mr. Dittmer addressed the company's improper advocacy regarding cash

[56] Tr. 324

[57] Public Counsel expressly reserves the right to argue the specifics of the revised protocol in this and any other proceeding wherein the Commission may decide to order its use. Tr. 620-22.

[58] Exhibit 3, Attachment A.

[59] Tr. 353-56, 478-79.

[60] Exhibit 3 at Attachment A.

working capital development, its improper amortization of recently settled tax disputes (i.e., IRS settlement payments), and miscellaneous other matters, it would be improper for the Commission to assume that Attachment A adequately reflects Mr. Dittmer's proposed adjustments since the settling parties have refused to identify the specifics behind the entries on either Attachments A and B to the proposed settlement.[61] Public Counsel witness Jim Dittmer looked at only a limited set of issues, and did not coordinate his adjustments with ICNU or Commission Staff.[62] It is simply impossible to determine the extent or overlap of a number of adjustments proposed by Mr. Dittmer or ICNU witnesses with adjustments listed on Attachment A to the settlement agreement.[63]

29. Briefly, Mr. Dittmer identified the short-comings in the company's direct case regarding cash working capital and the company significantly revised its testimony in its rebuttal case on this issue.[64] There is no evidence in the record that the proposed settlement in fact reflects Mr. Dittmer's adjustments and the Commission should not assume that it does based upon the unsupported representations found in Attachment A.

30. Mr. Dittmer as well as the Staff initially opposed all of the company's proposed adjustment to amortize over five years recent payments made to the Internal Revenue Service to settle disputes relating to tax years 1991 through 1998. Mr. Dittmer identified three independent bases for rejecting any allowance of IRS settlement costs – any one of which is sufficient for rejecting the totality of the company's proposed adjustment. Cumulatively, the three arguments

[61] Exhibits 8-11.
[62] Tr. 758.
[63] For example, employee benefits at Tr. 751.
[64] Exhibits 203 at 8.11, 204 at 15-17, 205 at 15, 206, 237, 239 at 3.01-3.13, 521, 525.

certainly support a disallowance of the company's proposed adjustment.[65] First, Mr. Dittmer pointed out the method of allocating the IRS settlement payment to the Washington jurisdiction (i.e., income before income taxes) had no justification. Second, Mr. Dittmer noted, and Pacificorp witness Martin agreed, that if a book/tax timing difference giving rise to a dispute were "normalized" for ratemaking purposes, no further charge to Washington retail ratepayers was warranted inasmuch as ratepayers would have paid such amounts to the company as a "deferred tax" even though such monies were not immediately tendered to the IRS. The record indicates that, at least at one point, Mr. Martin agreed that all items in dispute had been "normalized" and therefore no further charging to ratepayers is now appropriate. Finally, Mr. Dittmer pointed out that it is impossible to determine whether rates during the 1991 – 1998 time frame were sufficient to absorb additional IRS liabilities being incurred. While the Staff also initially rejected 100% of the company-proposed IRS settlement adjustment, they apparently conceded approximately half of such adjustment in settlement. Neither the settlement agreement, Staff testimony supporting the agreement, nor company's rebuttal testimony begin to address all three arguments raised by Mr. Dittmer in opposition to such company-proposed adjustment.

31. The proposed settlement apparently includes in cost of service rate development a number of Miscellaneous Deferred Debits/Regulatory Assets which Mr. Dittmer opposed. The majority of the transactions in dispute, identified by Mr. Weston in Exhibit 207, relate to transactions occurring within the Eastern control area of PacifiCorp.[66] This is the same Eastern control area which the Commission Staff ignored due to their approach to allocation. It is

[65] Tr. 731-32.

impossible for the Commission Staff to have determined the prudence of various miscellaneous deferred debits and regulatory assets which it is implicitly, if not explicitly, agreeing should be recovered in rates through the proposed settlement. Once again, the settlement agreement and supporting Staff testimony simply do not address why it is reasonable to incorporate in Washington retail rate development costs incurred in the Eastern control area, and deferred in a prior period, for current recovery from Washington ratepayers. [67] This Commission rejected a Pacificorp request to defer certain power supply costs citing the lack of a baseline upon which to determine what costs might be currently recovered in rates. Further, the Commission noted that without an agreed-upon jurisdictional allocation methodology, it would be impossible to even begin to determine what power supply costs might be included in current base rates.[68] As Mr. Dittmer testified, the same logic the Commission applied in rejecting the proposed power cost deferral in 2003 applies with equal force to the company's claimed miscellaneous deferred debits.[69] It would be contradictory for the Commission to allow costs in a manner logically inconsistent with the 6th/8th Order which gave rise to this proceeding. The sort of blanket approval of regulatory assets contained in the settlement should not be approved.

32. Finally, the company never sought Commission authority to defer a number of the costs which it now seeks to include in rates. It is important to remember that the ability to defer costs otherwise immediately expensed for financial and regulatory purposes should be the exception and not the rule. It is a unique and special privilege granted to regulated utilities, since deferrals

[66] Tr. 736. There is also no basis to believe that the alleged PC adjustments contain Mr. Dittmer's adjustments to the claimed Swift 2 Canal expenses. Exhibits 391-395, 521, and 526.
[67] Exhibits 207, 229, 238, 241, 521, and 527.
[68] Exhibit 450 at 30-31.
[69] Tr. 737.

are inherently asymmetrical.[70] Few events favorable to ratepayers are ever "deferred" for future crediting to ratepayers.[71] Given the black box nature of this settlement the Commission has no detailed itemization of precisely which deferred assets and liabilities are included in rates, much less any idea whether they are reasonable or should be allocated to Washington jurisdictional cost of service. It is not unreasonable to assume that if the settlement is approved the next rate case filed by the company will simply assume that the parties to the next rate case will be arguing over not only the content of that filing, but also the scope and impact of this settlement in that subsequent case.

4. The Environmental Remediation and Trail Mountain Mine provisions are unsupported by the evidence.

33. The proposed settlement also requests recovery through deferral accounting of costs associated with the closure of the Trail Mountain Mine and various environmental remediation costs.[72] When Mr. Schooley was cross-examined on Trail Mountain Mine costs, he admitted that since these were costs largely associated with the Eastern control area, and the Staff's hybrid approach ignored the Eastern Control area, the Commission Staff did not examine them.[73] Mr. Schooley also testified that the environmental remediation adjustments reflected in his responsive testimony are not specifically reflected in the Settlement.[74] Therefore, the settlement is clearly a "black box" on this issue.[75] This Commission has no assurance that there has been any critical assessment of the costs proposed for inclusion in rates associated with Trail

[70] Tr. 738.

[71] *Id.* Asset transfers such as the Centralia sale are the only recent example in Washington. Public Counsel cannot recall any company aggregating and seeking deferral of credits for the benefit of customers for items of similar scope and value as those sought for recovery by the company in this proceeding.

[72] Exhibit 3 at 7.

[73] Tr. 682; Exhibit 641 at 12-16.

Mountain Mine and any environmental costs associated with the Eastern control area (the majority of such costs). None of the non-settling parties have addressed those issues in this docket, and the company addressed them in only a conclusory fashion.[76] As ICNU witness Mr. Schoenbeck testified in surrebuttal these matters should not be part of this settlement and should remain in their own dockets for proper examination.[77] An adequate record does not exist and the issues have not been thoroughly examined by any party, including the Commission's own staff.

34. The proposed settlement is also internally inconsistent in its treatment of what is recoverable. The record now before the Commission does not allow the Commission to reconcile the resolution of Trail Mountain Mine and environmental remediation costs in the proposed settlement with the settlement's disparate treatment of resources acquired since 1986.[78]

35. As a legal matter, it is Public Counsel's position that deferred costs should only be recoverable on a going forward basis, from the date of the Commission's order allowing deferral. In the event that the Commission concludes in this docket that recovery of Trail Mountain Mine and environmental remediation costs are proper, then such costs should only be recoverable as of the date of the Commission's order.[79] The company's delay of two years before filing their petition certainly should weigh heavily on this issue.

5. The Cost of Capital and Rate of Return Implied in the Settlement are not in the Public Interest.

[74] Tr. 682-83.
[75] Mr. Schooley also expressed his more general concern with deferral accounting. Tr. 685.
[76] Exhibits 201 at 14-16, 204 at 12-13.
[77] Tr. 135.
[78] Exhibit 3 at 6. Similarly the settling parties' use of the original protocol can not be squared with their agreement on the prudency of recovery of costs associated with the Eastern control area. Tr. 339-40.
[79] See *Brief of ICNU and Public Counsel on Retroactive Ratemaking*, Dockets UE-991832/020417.

36. The proposed settlement between PacifiCorp and the Commission Staff identifies only an overall return and not any particular capital structure or component capital costs. Because of this it is difficult to represent the positions of the settling parties in a coherent fashion, in order that the issues can be identified and discussed. Even more importantly, this means there is no adequate record for the Commission to base a decision on. For purposes of discussion in this brief, it is assumed that the agreed-upon overall return is related to the company's requested capital structure. That assumption produces a lower equity return allowance than if the settled overall return were based on the capital structure recommended by Mr. Hill. Even with that assumption and the lower indicated equity return, the settlement produces an allowed return on equity that substantially overstates the company's cost of capital.

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37. With the clarifying assumption that the stipulation is based on the capital structure requested by the company, the following summarizes the positions of the parties:[80]

	Ratios (%)		Cost Rate (%)		Weighted Cost (%)	
Type of Capital	Public Counsel	Stipulation	Public Counsel	Stipulation	Public Counsel	Stipulation
Common Equity	44.09	47.08	9.375	10.50	4.13	4.94
Preferred Stock	1.42	1.41	6.72	6.72	0.1	0.09
Long-term Debt	52.94	51.51	6.51	6.51	3.45	3.35
Short-term Debt	1.54	-	2.74	-	0.04	0
TOTALS	100	100			7.72	8.39

It is important to note that if the overall cost of capital cited in the proposed settlement is based on the capital structure recommended by Mr. Hill, the effective return on common equity would be 10.90%, rather than the 10.50% shown in the table above.[81] Either equity return is substantially in excess of the current cost of common equity capital for PacifiCorp and thus, not in the public interest.

a. Capital Structure.

38. Regulatory Commissions consider a utility's capital structure when developing an appropriate cost of capital.[82] The Commission's Second Supplemental Order in U-82-02, PacifiCorp's 1986 rate case stated in part: "In determining the overall authorized rate of return, it

[80] Exhibit 667.
[81] Exhibit 427.

is first necessary to establish the appropriate capital structure for the company."[83] And yet, as previously noted, the proposed settlement is silent on all the details of the components that comprise the recommended 8.39% overall rate of return including capital structure. If it is assumed that the stipulated overall return is based on the capital structure recommended by Mr. Hill, then there is no dispute with regard to that issue and no further discussion is necessary.

39. However, for purposes of discussion, and to give the settling parties the "benefit of the doubt" regarding the return on equity included in the stipulation, it is assumed here that the stipulated overall return is based on the company's requested capital structure and embedded cost rates.[84] The reasons why Mr. Hill's recommended capital structure is the appropriate basis for setting rates are as follows:

- The company's requested capital structure is not an actual, booked capital structure.[85]
- The company's requested capital structure contains more common equity and less debt capital than actually employed by the company, on average, over the past five quarters.[86]
- The manner in which the company has elected to capitalize its operations over the most recent five quarters is: 44.09% common equity, 1.42% preferred stock, 52.94% long-term debt and 1.54% short-term debt.[87]
- The company's requested capital structure is similar to that of its riskier parent company, Scottish Power; and setting rates for PacifiCorp using a capital structure

[82] Charles F. Phillips Jr., *The Regulation of Public Utilities*, at 233 (3d Ed. 1993).
[83] Exhibit 510 at 30.
[84] Public Counsel will show that the lowest possible equity return implicit in the proposed settlement, 10.50% overstates the company's current cost of equity capital, making moot the overstatement of the 10.9% equity return implied by the proposed settlement overall rate of return and the use of Mr. Hill's recommended capital structure.
[85] Exhibit 631 at 25.
[86] Exhibit 631 at 25-26.
[87] Exhibit 657 at 1.

similar to its riskier parent would require the company's Washington ratepayers to provide an unnecessary financial cross-subsidy to Scottish Power's unregulated operations.[88]

- The company's requested capital structure contains substantially more common equity and less debt capital than exists, on average, for similar-risk companies in the electric utility industry.[89]

Importantly, the Company provided no rebuttal to Mr. Hill's recommended capital structure.[90]

b. Cost of Equity.

40. The evidence in the record does not support the 10.50% cost of equity which appears to be assumed in the settlement. The overall return adopted in the settlement has overstated the cost rate of common equity, particularly in the light of the fact that the company's own discounted cash flow (DCF) analyses, updated to be contemporaneous with those of Public Counsel, support the reasonableness of an equity cost estimate well below 10%. The appropriate cost rate of common equity for fully-integrated electric utility operations similar in risk to PacifiCorp ranges from 9.0% to 9.75%. The equity return implied in the settlement, 10.50% is substantially above even the highest end of that range of equity capital costs. The mid-point of the range of common equity costs for similar risk companies is 9.375%, which results in an overall rate of return of

[88] Exhibit 631 at 26-30.
[89] Exhibit 631 at 30-31; 657 at 3.
[90] For ratemaking purposes, if the Commission considers approving the proposed settlement it should condition approval on application of the capital structure and cost of equity recommended by Mr. Hill. Exhibit 657 at 5.

7.72% when applied to the company's most recent actual average capital structure, as recommended by Mr. Hill.[91]

41. Public Counsel's recommended 9.375% cost of equity capital and 7.72% overall rate of return not only serve the interests of PacifiCorp and its investors (i.e., providing those investors the return they require), but also assures adequate service to the public at the most reasonable cost (i.e., supporting the company's ability to attract capital). As witness Hill stated, a 9.375% equity return, operating through the company's actual capital structure affords the company an opportunity to achieve a pre-tax interest coverage of 2.87 times.[92] That interest coverage level, according to Standard & Poor's bond rating service is sufficient for a company of PacifiCorp's business risk to support an investment-grade bond rating. Also, that level of interest coverage is greater than that which PacifiCorp has actually achieved in 2002 and 2003.[93]

42. The company's rate of return witness, Dr. Hadaway, also used the DCF analysis in determining return on equity, using a sample of water and gas utilities. The results of Dr. Hadaway's standard (single-stage) DCF analysis, as reported in his testimony is 9.8%.[94] However, as Mr. Hill noted, Dr. Hadaway's analysis, completed in the Fall of 2003, is out of date. Simply replicating PacifiCorp witness Hadaway's standard DCF analysis using the most

[91] Mr. Martin alleged that the company was not receiving its authorized rate of return from 1991 to 1998. Yet, he failed to identify any Commission order that established an allocation methodology other than the one contained in the 1986 rate case for the simple reason that there are none. Exhibits 283 at 2, 290; Tr. 708. It is unreasonable for PacifiCorp, or its employees, to expect that the company should have earned 10.42% overall and 13.25% return on common equity during the mid-'90's when interest costs and the overall cost of money fell significantly between 1986 and the mid-'90s. Tr. 735-36.

[92] Exhibit 631 at 53.

[93] Data from PacifiCorp's Statements of Computation of Ratio of Earnings to Fixed Charges, Exhibit 12.1 to SEC form 10-Q, for the period ending December 31, 2003.

[94] Exhibit 45 at 2.

recent data available from Value Line, produces a DCF cost of common equity estimate of 8.9%.[95] Importantly, the 8.9% DCF result using Dr. Hadaway's methodology is un-rebutted in this docket and was not questioned by Dr. Hadaway in his rebuttal to Mr. Hill. Thus, PacifiCorp's standard DCF result confirms the reasonableness of Mr. Hill's DCF result (9.33%). It also confirms that the equity return implied in the settlement between Staff and PacifiCorp is substantially in excess of the company's cost of common equity capital, and is unsupported in the record now before the Commission.[96] With respect to cost of capital and capital structure issues, the settling parties have simply failed to present the Commission with sufficient evidence from which the Commission can conclude that the proposed settlement is in the public interest.

III. RECOMMENDATIONS

43. Public Counsel recommends that the Commission reject the proposed settlement and return the parties to a litigated proceeding. If the Commission decides to conditionally accept the proposed settlement Public Counsel first urges the Commission to make any rate increase subject to refund. As the Commission is aware, the propriety of the current rate case is currently a matter of appellate review before Division Two of the Washington state Court of Appeals.[97] If the court directs a remand to the Commission it is likely that such an order would have significant impact on the current proceeding.

[95] Exhibits 631 at 61, 668 at 1.

[96] If the Commission considers adopting the proposed settlement it should adopt an overall rate of return of 7.72% with a return on equity of 9.375% for PacifiCorp. This produces approximately a $10.8 million adjustment to the company's case as filed. This is in stark comparison to the proposed settlement's $3.5 million adjustment. Exhibit 3 at 5.

[97] *Public Counsel v. WUTC*, No. 31826-1-II.

44. The settling parties request that a rate increase be granted if the settlement is not accepted, subject to refund.[98] In the event that the settlement proposal is rejected there would be no legal or factual basis for the Commission to increase rates pending resolution of the general rate case. [99] The settling parties have stated they are not attempting to substantiate an interim rate request under the Commission's *Pacific Northwest Bell* standards, or any standard at all.[100] The settling parties have provided no alternative legal or factual basis for an interim rate increase other than their simple request that it be so. Public Counsel respectfully requests that in the event the settlement is rejected that the Commission not allow an interim rate increase.

IV. CONCLUSION

45. Public Counsel respectfully requests that the Commission reject the proposed settlement, and return the parties to a litigated proceeding. The proposed settlement now before the Commission is not in the public interest as it fails to address the concerns raised by the Commission in the order which broke the Rate Plan and allowed this rate case to be filed. Further, it is not supported by the record. Public Counsel requests that the Commission carefully consider the record in this proceeding, including the public testimony regarding the impact of any rate increase.[101] Public Counsel hopes the Commission will reach the outcome which best protects PacifiCorp's Washington ratepayers and which will lead to resolution of these long-

[98] Exhibit 3 at 10.
[99] Tr. 142.
[100] Tr. 348.
[101] Exhibit 30; Tr. _____.

standing, contentious issues.

RESPECTFULLY SUBMITTED this 8th day of October, 2004.

CHRISTINE O. GREGOIRE
ATTORNEY GENERAL

By: _____
ROBERT W. CROMWELL, JR.
Assistant Attorney General
Public Counsel