

1 **Q. Please state your name, business address and present position with**
2 **PacifiCorp (the Company).**

3 A. My name is Daniel J. Rosborough. My business address is 825 N.E. Multnomah,
4 Suite 1800, Portland, Oregon 97232. My present position is Director of
5 Employee Benefits.

6 **Qualifications**

7 **Q. Briefly describe your education and business experience.**

8 A. I have been employed by PacifiCorp for 22 years and I have served as the
9 Director of Benefits for approximately 12 years. I attended Lane Community
10 College and the University of Oregon.

11 **Q. Please describe your current duties.**

12 A. My responsibilities include the analysis, design, administration and compliance of
13 the Company's health and welfare and retirement programs.

14 **Purpose of Testimony**

15 **Q. What is the purpose of your testimony?**

16 A. My testimony addresses the Company's pension and welfare benefit costs. All
17 costs are presented on a system-wide basis. In the first section of my testimony, I
18 will describe two types of PacifiCorp's pension costs the Company is seeking to
19 recover in this case. The Company proposes to recover in base rates \$49.9
20 million in annualized pension costs for PacifiCorp's defined benefit pension plan.
21 The Company is also seeking to recover in base rates \$3.0 million in pension
22 expense associated with a contribution for the significant majority of employees
23 of PacifiCorp represented by the International Brotherhood of Electrical Workers

1 (“IBEW”) Local 57. This is a separate pension plan negotiated with the IBEW.
2 In the second section of my testimony, I describe the Company’s proposal to
3 recover in rates \$112.1 million in medical, dental and other benefit coverage costs
4 and explain the major reasons for the increase in those costs. I also describe the
5 actions the Company is taking to control those costs.

6 **Pension Expense**

7 **Q. Who actually participates in the company retirement plans?**

8 A. As of January 1, 2004, the PacifiCorp Retirement Plan has approximately 4,520
9 active participants and the Local 57 plan approximately another 1,460.

10 **Defined Benefit Pension Plan Expense**

11 **Q. What is the plan’s current funding status?**

12 A. The plan is currently underfunded. This situation exists for two primary reasons:
13 unusually low interest rates (which means the current valuation of liabilities is
14 artificially high, thereby increasing the amount of “expense” that is required to
15 cover the cost of the Plan); and poor investment returns over the 2000 – 2002
16 period when most investment markets have performed poorly. Strong investment
17 performance in 2003 and 2004 and significant cash contributions (the Company
18 contributed \$61 million in April of 2004) have stabilized and actually improved
19 the funded status over the past 18 months. As of January 1, 2005, the plan’s
20 funded status was approximately 70 percent. The Company also expects to make
21 cash contributions of \$60 million in April 2005.

22 **Q. How is the Company’s pension expense determined?**

23 A. The expense for the plan is determined annually by an independent actuary,

1 Hewitt Associates, as prescribed by the Financial Accounting Standards Board
2 through its accounting standard governing the calculation of pension expense
3 (SFAS 87). Under SFAS 87, the pension expense amount is calculated by the
4 actuary based upon the actual demographics of the participants in the plan, the
5 expected benefits to be paid, expected terminations and retirements, expected pay
6 raises, current interest rates for valuing the plan's liabilities, and a forecast of the
7 expected long-term rate of return on plan assets. Pension expense is calculated by
8 the actuary on a calendar year basis but SFAS 87 permits this calculation to be
9 used by companies utilizing a different fiscal year, such as PacifiCorp, provided
10 the fiscal year end is no more than three months after the calendar year end. To
11 the extent that actual investment returns and other experience with the plan differ
12 from these expectations, the differences are amortized into future expense once
13 they exceed a certain threshold.

14 **Q. What is the level of pension expense included in the Company's request?**

15 A. The Company is seeking to recover \$49.9 million in expected pension expense.
16 This is the amount of pension expense the Company expects to incur in FY 2006
17 (fiscal year 2006 ends March 31, 2006). The amount is based on actual FY 2005
18 expense of \$31.5 million which was a SFAS 87 actuarial calculation conducted by
19 the Company's actuary, Hewitt Associates. This calculation is included in the
20 actuarial report which is provided as Exhibit No.__(DJR-2). The FY 2006
21 calculation was developed using the actual 2005 expense as a baseline and
22 incorporating an actual investment return of 11.5 percent for the 2004 calendar
23 year. The calculation also uses a discount rate of 5.75 percent to value the plan's

1 liabilities. Exhibit No.__(DJR-3) explains the allocation of FY 2004 and FY
2 2005 pension expense and Exhibit No.__(DJR-4) provides a reconciliation of
3 projected FY 2006 pension expense to actual FY 2005 pension expense. Both
4 pages of this exhibit were prepared by Hewitt Associates. The filing also requests
5 recovery of \$3.0 million in pension expense related to contributions to the IBEW
6 Local 57 Retirement Plan that the Company intends to make in February 2006.

7 **Q. Why is the expected cost rising so dramatically?**

8 A. The PacifiCorp Retirement Plan expense increased dramatically from FY 2004
9 (\$14.8M) to FY 2005 (\$31.5M) and is expected to increase dramatically again in
10 FY 2006 (\$49.9M). The average increase between 2004 through 2006 is \$17.55
11 million per year. This is primarily due to investment losses which occurred
12 between 2000 and 2002 and discount rates that have now remained at historic
13 lows for several years. During those three years, the Plan experienced \$450
14 million of asset losses (the difference between actual investment loss and the
15 amount of return assumed by the actuary). Reflecting those losses has an obvious
16 and significant impact on pension expense. However, because we spread each
17 year's gains and losses over the succeeding five years (spreading losses and gains
18 to mitigate volatility is allowed under SFAS 87 and is a common spread practice
19 among large pension plans), the resulting increase in pension expense is smoothed
20 over the period. Thus, what could be a really dramatic increase in pension
21 expense is smoothed. But that also means that the aggregate of these gains and
22 losses (for FY06, this is a net loss) is built into the succeeding years' pension
23 expense until it is fully amortized, so it will take until 2008 for the earlier losses

1 to be fully recognized and eliminated. The expense pattern for the IBEW
2 Local 57 Retirement Plan has been steadier and actually declined since it reached
3 \$5.65M in FY 2004. We expect that the need for continuing contributions will
4 not reach FY 2004 levels until after FY 2007.

5 **Q. Are the pension plans of other utilities impacted by the same economic**
6 **conditions?**

7 A. Yes. PacifiCorp is no different than other utilities, or plan sponsors in other
8 industries for that matter. Trust fund investments over the 2000 - 2002 period
9 performed poorly for almost every large fund, and interest rate declines inflate the
10 liabilities of all pension plans. Investment returns were strong in 2003 and 2004
11 which helped asset growth, but interest rates not only remained very low, but are
12 approximately 100 basis points (as of March 2005) lower than in 2002, which
13 means that liabilities of plans have stayed very high.

14 **Q. What does the Company expect to happen to pension expense after FY 2006?**

15 A. Using the same baseline data utilized in the FY 2006 analysis, we expect pension
16 expense for the PacifiCorp plan to increase to \$52.8 million in FY 2007, as
17 projected by Hewitt Associates (see Exhibit No.__(DJR-5). This analysis is
18 based on assets earning 8.75 percent during 2005 and an increase in the discount
19 rate to 6.0 percent.

20 **Q. Who oversees the money that is contributed to the Company's pension plan?**

21 A. The Company has appointed a Committee (PacifiCorp Pension Investment
22 Committee) that has a fiduciary responsibility to oversee the prudence of the
23 investment of those assets and determine the asset allocation investment strategy.

1 All plan assets are held in a trust and those assets can be used only for the benefit
2 of plan participants. PacifiCorp's Committee has retained outside consultants to
3 assist in this function and has delegated the actual investment responsibility to
4 outside professional investment managers. The plan assets are broadly diversified
5 across asset classes and investment managers. Relative to comparable corporate
6 plans, over the last five years the PacifiCorp plan's investment returns have been
7 comparable to those of median peer plans.

8 **IBEW 57 Pension Expense**

9 **Q. Please describe the IBEW 57 pension expense.**

10 A. The Company contribution for this expense is subject to the collective bargaining
11 process. In accordance with that process, the Company made a \$5 million
12 contribution in 2003, \$5.6 million contribution in 2004, but no contribution for
13 2005. The Company proposes to include in rates the budgeted contribution of
14 \$3.0 million for FY 2006 for the Local 57 Plan. The reason for the lower FY
15 2006 contribution (relative to 2003 and 2004 levels) is that the plan's investment
16 return was favorable in 2003 and 2004 and the necessity of additional cash
17 contributions has lessened. When the plan was first established pursuant to
18 collective bargaining in 1998-1999, the union and the Company agreed that the
19 Company would contribute 7 percent of eligible pay to the plan, but that favorable
20 investment returns would prompt negotiations to determine and agree upon a
21 more appropriate contribution level.

1 **Q. Why is this pension expense separate from the defined benefit plan expense**
2 **discussed above?**

3 A. Simply because it is a separate plan. The Local 57 plan was negotiated in
4 1998/1999 and effective July 1, 1999. PacifiCorp is not the plan sponsor but is
5 contractually obligated through the collective bargaining process to make
6 contributions on the behalf of employees represented by Local 57 (who work in
7 Idaho, Utah and Wyoming) and eligible to participate. Prior benefits earned by
8 these same employees, and assets to pay the benefits, were transferred to this new
9 plan in 2001 and those benefits are now the obligation of that Trust and not the
10 obligation of the PacifiCorp Retirement Plan.

11 The Trustees of the PacifiCorp/IBEW Local 57 Retirement Trust now
12 manage these assets. There are four Trustees from PacifiCorp management and
13 four from Local 57 IBEW leadership. The Trust employs professional actuarial
14 consultants, administrators, an attorney, an auditor and investment managers.
15 PacifiCorp provides funding to the plan based upon a collectively bargained
16 agreement and annual negotiations.

17 **Medical, Dental and Other Benefit Coverage Costs**

18 **Q. What level of medical, dental and other benefit costs are included in the**
19 **Company's revenue requirement in this case?**

20 A. The Company expects to record \$110.6 million in FY 2006 for medical, dental
21 and other benefit costs that it expects to incur. This represents an increase of \$9.5
22 million over the equivalent FY 2005 expense of \$101.1 million. These amounts
23 include costs associated with the Supplemental Executive Retirement Plan

1 incurred during the twelve months ending September 2004.

2 **Q. Please explain the reasons for the increase in these costs.**

3 A. The increase in medical coverage costs is the primary reason for the increase in
4 these costs. PacifiCorp's health plans, like almost every other health plan in the
5 United States, have been experiencing significant increases in medical inflation.
6 The primary drivers behind the increases are:

- 7 • A lesser degree of effectiveness of managed care plans. It is widely believed
8 that after several years of successful negotiations with providers to minimize
9 annual cost increases, the "market" has now turned and providers are being
10 more successful at negotiating increases with managed care networks;
- 11 • Government mandates and continued cost shifting by government plans to the
12 private sector;
- 13 • An aging population;
- 14 • The cost of prescription drugs, compounded by very effective direct consumer
15 marketing;
- 16 • Increased prevalence of chronic and high cost treatment; and
- 17 • Development and expansion of new medical technology.

18 **Q. How do the medical cost increases that PacifiCorp has been experiencing**
19 **relate to the cost increases being experienced by other employers?**

20 A. Over the past several years, PacifiCorp's record with respect to cost increases in
21 medical plans compared favorably to that of other employers. Exhibit
22 No.__(DJR-6) outlines the recent history of increases for PacifiCorp's primary
23 health plans relative to how a similar set of plans would have fared using national

1 medical inflation experience. As the exhibit demonstrates, PacifiCorp's plans
2 have performed better than the average plan experience. As illustrated in this
3 Exhibit, PacifiCorp's electric operations group has experienced a six-year
4 increase of 68.6 percent in medical costs while the national average for the same
5 types of plans has increased by 75.3 percent.

6 **Q. Has PacifiCorp made any changes to its medical programs or practices to try**
7 **to mitigate the cost increases?**

8 A. Yes. Over the past few years, a number of changes have been incorporated into
9 the PacifiCorp plan design to attempt to mitigate cost increases, including:

- 10 • Implementation of a mail order prescription drug program. These programs
11 have proven effective at slowing the increases in this area, which for most
12 plans has been the most difficult cost challenge.
- 13 • Expansion of geographic locations offering managed care plans. In areas
14 where a managed care plan can be supported, the Company has expanded
15 these offerings accordingly.
- 16 • The plan has for several years included a fully paid physical exam benefit for
17 covered individuals. In order to continue to emphasize long term cost savings
18 and improved health through a "preventive medicine" approach, this benefit
19 was slightly improved in 2003.
- 20 • The Company has continually expanded the educational materials and
21 resources for plan participants in order to make them better consumers of the
22 plan and better able to utilize plan benefits. Included in this arena is access to
23 a 24 hour Nurse Advice Line, an on-line health risk assessment tool and

- 1 • access to specialty programs for transplants and other high costs claim areas.
- 2 • Employee cost sharing has steadily increased over the past several years
- 3 through increases to annual out of pocket limits. During 2004, the Company
- 4 paid 91 percent of the total plan cost and employees paid 9 percent. This cost
- 5 sharing was adjusted again in 2005 so that employees paid 10 percent of the
- 6 monthly cost of the plan.
- 7 • Elimination of the \$100 deductible medical plan. This plan option was the
- 8 least cost effective plan offered by PacifiCorp and was eliminated in 2005.
- 9 • Implementation of a Consumer Driven Health Plan and a Disease
- 10 Management program. These plans are anticipated to be instrumental in
- 11 controlling the long term cost challenges of our programs.
- 12 • In 2004, the Company implemented changes to the prescription drug program
- 13 to increase the cost share borne by employees and further encourage the use of
- 14 generic drugs.

15 **Q. Does this conclude your direct testimony?**

16 A. Yes.