Q. Please state your name and business address.

A. My name is Jeffrey K. Larsen. My business address is One Utah Center, Suite 2000, 201 South Main Street, Salt Lake City, Utah 84140.

Qualifications

Q. What is your current position at PacifiCorp (the Company) and your previous employment history with the Company?

A. I am currently employed as Director of Revenue Requirement. I joined the Company in 1985, and I have held various accounting and regulatory related positions prior to my current position.

Q. What are your responsibilities as Director of Revenue Requirement?

A. My primary responsibilities include the calculation, justification and reporting of regulated earnings, interjurisdictional cost allocations and communications with regulators on jurisdictional embedded cost-related issues in the six jurisdictions in which the Company provides retail electric services.

Q. What is your educational background?

A. I received a Master of Business Administration Degree from Utah State University in 1994 and a Bachelor of Science Degree in Accounting from Brigham Young University in 1985. In addition to my formal education, I have also attended various educational, professional and electric industry related seminars during my career at the Company.

Purpose of Testimony

Q. What is the purpose of your testimony?

A. My testimony presents evidence that, based on its normalized 1998 results of operations, PacifiCorp is earning an overall return on rate base (ROR) in its Washington service territory of 6.5 percent. This return is less than the ROR currently required to provide a fair and equitable return for the Company's shareholders. In support of this conclusion, I introduce and describe the Company's Washington Results of Operations Report for the twelve months ended December 31, 1998. In describing the 1998 results of operations, I indicate the sources of the base data and describe appropriate normalizing adjustments.

Results of Operations

Q. Please describe Exhibit ___ (JKL-1).

A. Exhibit ___ (JKL-1) shows that, given the $609 million of proforma rate base utilized to serve Washington customers, PacifiCorp needs a $25.8 million rate increase so that the Company can have an opportunity to earn a fair return on rate base.

Q. Please describe Exhibit ___ (JKL-2).

A. Exhibit ___ (JKL-2) is the Company's Washington Results of Operations Report for the twelve-month test period ended December 31, 1998. I will hereafter refer to this exhibit as the results or the report. The report details revenues, expenses and rate base assigned to the Company's Washington service territory.

Q. Was the report prepared under your direction?

A. Yes.

Q. What allocation method has been used to assign costs to the Washington Jurisdiction?

A. The Modified Accord Allocation Method (Modified Accord) has been used to allocate the base data and adjustments. However, the Company is also proposing an adjustment to the Modified Accord as explained in Adjustment 4.12 of Exhibit ___ (JKL-2).

Q. Please explain the components of Modified Accord.

A. Modified Accord was developed by the PacifiCorp Interjurisdictional Task Force on Allocations (PITA), and is supported by a number of its participants. Modified Accord embodies the current status of over ten years of discussion and analysis by PITA members – a process that remains ongoing. The distinctive features of Modified Accord are the divisional assignment of pre-merger plant and an adjustment to fuel cost. Plant that was in-service prior to the merger of Pacific Power and Utah Power in 1989 has been assigned to the originating division. Plant-related costs such as O&M, depreciation, and taxes have followed the plant allocation. The adjustment to fuel costs represents the benefits of hydro generation that was financed primarily by pre-merger Pacific Power. This adjustment assigns a credit to each division based on the amount of hydro output contributed to the total system from the divisions multiplied by the difference in O&M costs between steam and hydro resources (see Exhibit ___ (JKL-2), Tab 10, page 27).

Q. Please describe the contents of the results.

A. The results provide twelve-month totals for revenues and expenses, and express rate base as the average of beginning and end-of-year balances. Operating results for the period are presented in terms of both return on rate base and return on equity. The results begin on page 1.0 with a summary of the normalizing adjustments to actual 1998 results. The unadjusted results (Column 1) are a product of allocation factors derived from weather-normalized loads. Column 2 summarizes the effect of Type 1 Adjustments (normalization for out-of-period adjustments, unusual items that occur during the test period, and Commission ordered adjustments) and Type 2 Adjustments (annualization of changes that occurred during the test period). These adjustments are combined with test period results to produce "Total Adjusted Actual Results" (Column 3). Column 4 summarizes Type 3 Adjustments (known and measurable items that will occur in a future test period). These adjustments result in the "Total Adjusted Results" in Column 5. Column 6 shows the increase in Washington revenues that would be required for the Company to earn an 11.25 percent return on equity from its Washington operations. Column 7 reflects the total adjusted results with this revenue increase included. For comparison purposes, page 1.0 reflects returns on rate base and equity for both the unadjusted and normalized results.

The unadjusted results allocated to Washington using the Modified Accord allocation method are detailed under Tab 2. Supporting documentation for the data in Tab 2 is provided under Tabs B1 through B20. The total column of the unadjusted results on page 2.2 corresponds to the actual data recorded in the Company's accounting records. The normalizing adjustments, which are required to smooth the impact of any unusual events which may have occurred during the test period or forecast costs for the test period, are identified on pages 1.1 through

1.4 and further documented under Tabs 3 through 9. The calculation of the Modified Accord allocation factors is described under Tab 10.

Q. What conclusions do you draw from the results of operations summary presented on page 1.0?

A. I observe that an overall price increase of $25.8 million is required to allow the Company an opportunity to earn the fair rate of return recommended by Mr. Peressini.

Development of Base Data (Unadjusted Results)

Q. Please explain the process for compiling the base data used in the results.

A. The revenue, expense and rate base data which comprise the unadjusted results of operations is extracted directly from the Company's accounting system and has been summarized under Tabs B1 through B20. The extraction process is largely a matter of downloading information from computer files, supplemented by manual inputs.

Q. Does the unadjusted base data fairly represent the Company's results of operations for 1998?

A. The base data reflects the operating environment and the unique set of circumstances that occurred during calendar year 1998. To adequately reflect results on a going-forward basis, it is necessary to make certain adjustments to reflect normal conditions. These adjustments annualize or proform specific events in the test period or normalize unusual events. The following section uses the term normalizing adjustment in a generic sense to refer to both annualization of in-period events, the proforma of specific future events, and normalization of unusual events.

Normalizing Adjustments

Q. Please describe what you mean by normalizing adjustments.

A. In reporting its results, the Company's goal is to develop a "typical" test period, free from effects of unusual events that reflects costs when prices will be in effect. Normalization adjusts for the impact of unusual, non-recurring events or includes the impact of known and measurable items. The Company's 1998 early retirement program is an example of this type of unusual impact. As I indicated earlier, adjustments for out of period events and unusual items that occurred during the test period are categorized as Type 1 Adjustments in the results. Normalization also requires an adjustment for the effect of changes that occur part way through the test period. For example, a wage increase that takes place in March should be adjusted to reflect a full twelve-month impact. This type of adjustment is also known as annualization and is referred to as a Type 2 Adjustment in the report. Normalization also includes adjustments ordered by the Commission in the last general rate case.

Normalizing adjustments need not be restricted to events that occurred within the test period. PacifiCorp believes that to most effectively match prices with anticipated conditions in the rate-effective period, it is necessary to reflect significant known and measurable out-of-period adjustments in the ratemaking process. For example, Adjustment 4.4 matches costs and benefits realized in 1999 for employees who qualified under the 1998 early retirement program but did not separate from the Company until 1999. The inclusion of known and measurable out-of-period events is referred to as a Type 3 adjustment in the results.

Q. Would you explain each of the 1998 normalizing adjustments?

A. Yes. The report detail under Tabs 3 through 9 supports the summary sheets on pages 1.1 through 1.4 and the normalized returns on page 1.0. Considerable description for each of the adjustments is provided within Exhibit ___ (JKL-2). However, I believe it will be useful to review these explanations at this point in my testimony. In order to understand why the Company believes that the normalized returns on rate base and equity that have been developed are reasonable predictors of future performance, it is necessary to understand the reasons for the underlying adjustments. I will discuss the adjustments in the order in which they are presented in Tabs 3 through 9, i.e., revenue, O&M, net power costs, depreciation and amortization, taxes, and rate base. For discussion purposes the adjustments will be presented in pre-tax dollars, where applicable. The income tax effect of each adjustment is calculated and reflected on the summary page following each tab.

Q. Please explain the revenue adjustments summarized under Tab 3, page 3.0.

A. **Weather Normalization** (Adjustment 3.1) – Weather normalization reflects weather or temperature patterns that were measurably different than normal, as defined by thirty-year historical studies by the National Oceanic & Atmospheric Administration. Only residential and commercial sales are considered weather sensitive. Industrial sales are more sensitive to specific economic factors. Costs have been normalized through adjustments to loads used to develop allocation factors and net power costs. This adjustment decreases 1998 Washington residential revenues by $1,510,000 and commercial revenues by $252,000.

Effective Price Change (Adjustment 3.2) – The price change adjustment annualizes existing contracts and tariff changes to reflect a full year of revenues based on the new rates. The annualization is done by comparing actual revenues in the test period to the annualized revenues calculated by applying the new rates in the contracts and tariffs to current energy usage. There were no tariff changes during the test period. However, certain special contract changes occurred. Adjustment 3.2 results in a net increase of $40,548 in Washington test period revenues.

Revenue Normalizing (Adjustment 3.3) – This adjustment normalizes 1998 revenues by recognizing out of period adjustments. This adjustment removes prior period items. In addition, the direct assignment of Portland General Electric customer choice pilot program revenues to Oregon; and Puget Power customer choice pilot program revenues to Washington are reversed. They are re-allocated on a system-wide basis that is consistent with the allocation of the associated costs. Adjustment 3.3 decreases Washington situs and increases Washington's allocated share of revenues from system contracts and pilot program revenues for a net revenue increase of $61,087.

SO2 Emission Allowances (Adjustment 3.4) – Adjustment 3.4 follows the Accounting Order granted in UE-940947. This Order allows amortization of the gain from the sale of SO2 emission allowances over a fifteen-year period with deferral of taxes to match amortization period, and with consideration in rate base for the unamortized gain. Amortization begins in the month a sale occurs. Adjustment 3.4 reduces rate base by $3,369,285 and increases miscellaneous revenue by $722,591 along with the deferred income tax effects.

USBR/UKRB Discount (Adjustment 3.5) – Under existing contracts with PacifiCorp, the U.S. Bureau of Reclamation (USBR) and the Klamath Basin, Water Users' Protective Association (referred to as Upper Klamath River Basin or UKRB) receive a reduced price compared to fully tariffed irrigation customers in return for allowing PacifiCorp to control stream flows from the Link River dam. These contracts preserve the Company's interests in three downstream hydro projects on the Klamath River. The reduced irrigation revenues have been booked as situs revenues of Oregon and California. However, since all customers share in the benefits of the hydro production from these plants, it is appropriate that the costs be shared in the same way. This treatment was developed and approved by state regulatory representatives through the PITA process in 1997. As part of the pending California sale, PacifiCorp will pay the buyer $7 million to assume the rate discount liability to California irrigators. The California costs have been reflected as a prepaid hydro cost that will be amortized over seven years, beginning in 2000. This adjustment treats the discount as a cost of PacifiCorp's entire hydro system rather than as a state specific cost, thereby increasing Washington's allocated share of hydro and other power supply expense by $578,258 and increasing Washington allocated rate base by $711,576.

Hassle Free Allocation Correction (Adjustment 3.6) – Hassle Free is an Oregon program, and the associated revenues should be directly assigned to Oregon.

However, through an error in the allocation of actual results, Hassle Free revenues were assigned system-wide on a System Overhead (SO) allocation factor in the results of operations report. This adjustment corrects the allocation error. Adjustment 3.6 decreases Washington test period revenues by $145,802.

Schedule 98 Credit (Adjustment 3.7) – The Northwest Power Act allows certain PacifiCorp customers to benefit from lower cost Bonneville Power Administration (BPA) power supplies. The customers receive a credit on their bill (Schedule 98/34), and PacifiCorp receives money from BPA as a reduction in Purchased Power expense. This adjustment removes the effect of the regional exchange program from revenue and expense since it does not reflect PacifiCorp's cost of service. Due to the pass-through nature of the exchange, this adjustment has no effect on revenue requirement.

Q. Please explain the O&M adjustments summarized under Tab 4, page 4.0.

A. **FAS 106 Deferred Charges** (Adjustment 4.1) – Financial Accounting Standard (FAS) 106 established accounting as well as disclosure standards for employers with post-retirement benefit plans. It requires that post-retirement benefit expenses be recognized or accrued while employees are actively employed and earning these benefits rather than after they have retired. Under the accrual accounting method the annual benefit expense is determined through actuarial studies. Prior to this, PacifiCorp was accounting for these benefits on a pay-as-you-go (i.e. cash) basis. Under the pay-as-you-go method, the annual benefit expense is equal to the amount that the Company actually paid to retirees during the year. The Oregon Public Utility Commission and the Wyoming Public

Service Commission authorized the Company to defer FAS 106 costs that exceeded pay-as-you-go until 1996. In 1996 the Company stopped deferring this difference and began amortization of the accumulated balances. The deferred costs are now being amortized to Account 929, which is allocated system wide on a SO factor. This adjustment is necessary to correct the allocation of these costs, which should be directly assigned to Wyoming and Oregon. The adjustment reverses the amount being allocated system-wide. Adjustment 4.1 decreases Washington allocated expense by $134,869 and decreases rate base by $31,822.

Market Position & Futures (Adjustment 4.2) – This adjustment removes the impact of costs and revenues associated with market position trading and futures contracts from the test period. Since the Company has greatly curtailed its involvement in these types of transactions, the 1998 activity is not indicative of ongoing revenue and expense. Adjustment 4.2 reduces Washington allocated revenues by $121,422,050 and reduces Washington allocated operating expense by $122,119,663.

1998 Early Retirement (Adjustment 4.3) – In 1998, PacifiCorp announced an early retirement program, targeted primarily at reducing the number of corporate staff and administrative support personnel. A total of 981 qualified employees opted to take advantage of this program. Those who qualified for early retirement were able to begin leaving the Company in April 1998. This adjustment removes Washington's allocated share of nonrecurring costs incurred in 1998 in connection with this early retirement program from the test period, and amortizes these costs over a five-year period. The savings associated with a reduced workforce have been captured in the Labor Cost Adjustment (Adjustment 4.5). Adjustment 4.3 decreases Washington operating expenses by $8,459,745, decreases rate base by $1,919,817 (the unamortized balance of early retirement costs), and properly reflects associated deferred income tax effects.

Pro Forma 1998 Early Retirement Adjustment (Adjustment 4.4) – Referring to the early retirement program previously described in Adjustment 4.3, this adjustment recognizes additional nonrecurring costs incurred in 1999 in connection with that program, and amortizes these costs over a five-year period. Adjustment 4.4 increases Washington operating expenses by $30,378, increases rate base by $106,322 and properly reflects associated deferred income tax effects.

Labor Cost Adjustment (Adjustment 4.5) – Adjustment 4.5 restates test period expense to reflect cost reductions resulting from reduced staffing levels that are expected to occur between 1998 and June 2001. These cost savings are partially offset by the effect of projected wage and incentive increases during the same period. Most of the employee reductions and the associated labor savings are attributable to the 1998 Early Retirement Program and a Refocus Program (see Adjustment 4.8). Adjustment 4.5 decreases Washington's allocated share of operating and maintenance expense by $480,558.

Remove Prior Year Incentive Accrual (Adjustment 4.6) – In 1998, an additional amount of expense related to 1997 incentive awards was accrued to properly reflect the amount paid out for 1997. This adjustment removes this prior period accrual. Adjustment 4.6 reduces Washington allocated expense by $246,907.

Pension Adjustment (Adjustment 4.7) – In 1997, PacifiCorp adopted the method of recognizing pension expense mandated by Financial Accounting Standard (FAS) 87/88 for financial reporting purposes. However, for ratemaking purposes the Company has been allowed to treat FAS 87/88 pension costs on a pay-as-you-go basis by its regulatory commissions. Rather than continuing to maintain separate regulatory accounting records based on pension funding levels as opposed to the FAS 87/88 accrual levels, the Company elected to follow FAS 87/88 for accounting and ratemaking and to amortize the regulatory asset for FAS 87/88 over five years. This adjustment increases the pension expense recorded in the 1998 test year by the amount of this amortization. Adjustment 4.7 increases Washington's allocated share of pension expense by $1,507,733 and reflects the appropriate deferred income tax effects.

Refocus Program Savings (Adjustment 4.8) – In October 1998, the Company announced a Cost Reduction Program totaling $30 million in savings. This adjustment reflects the anticipated non-labor savings associated with that program. The labor savings have been incorporated in the Labor Cost Adjustment (Adjustment 4.5). Certain related expenses have been captured in the Early Retirement adjustments (Adjustments 4.3 and 4.4) and are being amortized over five years. Adjustment 4.8 decreases Washington allocated expenses by $1,509,694.

DSM Third Party Financing (Adjustment 4.9) – In February 1995, PacifiCorp transferred its weatherization loans to its wholly-owned subsidiary, DSR, Inc., and Citibank purchased 72.27 percent of these loans from the subsidiary. In 1995, 1996 and 1997, this adjustment reflected the interest expense paid to Citibank on the transferred loans, and adjusted rate base to include the weatherization loan balances that remained on DSR, Inc.'s books. However, by 1998, it had become apparent that DSR, Inc. was not meeting the original expectations in terms of expected cost advantages. Therefore, in November 1998, DSR, Inc. purchased all the loans back from Citibank at book value, and in December 1998, transferred all of the loans back to the Company. This adjustment is necessary to reflect the loan amounts as though they had been on the Company's books since January 1, 1998. Adjustment 4.9 increases Washington revenues by $159,674 and increases rate base by $1,988,115.

Non-Regulated Pension Expense (Adjustment 4.10) – PacifiCorp bills its non-regulated subsidiaries for benefits provided to their employees. Certain pension expenses and post retirement benefits billable to subsidiaries were inadvertently left in Administrative & General Expense in 1998. This adjustment removes those expenses from the test period. Adjustment 4.10 reduces the Administrative & General expense allocated to Washington by $52,513.

Uncollectible Accounts (Adjustment 4.11) – This adjustment is necessary to correct the allocation of uncollectible accounts expense. During 1998, most of the Company's bad debt expense was recorded using a general office accounting location. Use of this location caused the jurisdictional allocation reporting system to allocate these costs on a Customer Number (CN) factor rather than directly assigning them to the appropriate jurisdiction. This adjustment corrects that allocation error, reversing the CN allocation and directly assigning Washington's bad debt expense. The allocation correction increases Washington bad debt expense by $2,083,077.

Modified Accord Allocations (Adjustment 4.12) – Adjustment 4.12 consists of two components related to the divisional assignment of pre-merger plant in the Modified Accord Method. The first component represents the natural movement of costs from a divisional allocation to a system allocation as a result of the depreciation of pre-merger plant and the addition of post-merger plant. The revenue requirement difference between the divisional assignment of plant and a system allocation of the same plant has been declining on average by $572,071 per year on a Washington allocated basis. This component of the adjustment incorporates the natural decline in the allocation difference into the forecasted test period and results in an increase in Washington jurisdictional expense of $1,430,177.

The second component of the adjustment represents an accelerated amortization of the difference in allocations due to pre-merger plant over a five-year period beginning in 1999. After the five-year period, all plant that is currently assigned on a divisional basis would be allocated on a system basis. This proposal includes in revenue requirement the cumulative difference between the natural decline in allocations mentioned above and the annual amortization required to complete the phase-out of the differences over five years. This adjustment was proposed by the Company at the October 28-29, 1999 PITA meeting. This component of the adjustment increases Washington jurisdictional expense by $286,035.

The Company proposes that the Commission include the impact of the first component of the adjustment in the rates resulting from this proceeding. The Company believes this is appropriate as the adjustment represents application of the allocation method currently endorsed by the WUTC Staff. The Company proposes that the Commission also include the second component of the adjustment subject to one condition; that condition being the endorsement of the proposed adjustment through a written agreement signed by PacifiCorp and other PITA members. Furthermore, should an adjustment different from that proposed by the Company receive a similar endorsement, the Company requests that the revised adjustment be reflected in this proceeding.

System Benefits Charge - DSM (Adjustment 4.13) – To stabilize demand side management (DSM) expenditures at a specified level PacifiCorp proposes establishing a system benefits charge, as described in Mr. Hedman's testimony. To be consistent with the system benefits charge proposal this adjustment removes DSM expenses of $807,591 from the test period.

Tree Trimming Expense Adjustment (Adjustment 4.14) –PacifiCorp expects on-going annual tree trimming expenses to be $2,500,000. This adjustment normalizes tree trimming expense to the expected level by increasing operating expense by $970,315.

Renewable Resource Adjustment (Adjustment 4.15) – RCW 80.28.025 was enacted to encourage utility investments in renewable and cogeneration power resources by allowing a two percent equity return premium on such investments. PacifiCorp invested in a wind mill farm located in Wyoming, and cogeneration power plants in Camas, Washington and Hermiston, Oregon. This adjustment reflects the revenue requirement of the premium on PacifiCorp investments in windmills and cogeneration power plants by increasing power production expense by $361,372.

Q. Please explain the Net Power Cost adjustments summarized under Tab 5, page 5.0.

A. **Net Power Cost Study** (Adjustment 5.1) – As described in Mr. Widmer's testimony, the net power cost adjustment normalizes steam and hydro power generation, fuel, purchased power, wheeling, and sales for resale in a manner consistent with normalized operation of production facilities. These costs and revenues are normalized because they are sensitive to weather conditions and the wholesale market. Adjustment 5.1 reflects sales for resale, fuel, purchased power and wheeling expense based on normalized stream flow and weather conditions for the period ending December 31, 1998. This adjustment also removes the Centralia generating plant as a resource, reflects the sale of the Company's Montana and California service territories and includes known and measurable contract changes through June 2001. Other aspects of the Centralia plant sale are explained in Adjustment 8.12. Adjustment 5.1 reduces Washington revenues by $32,208,432 with an offsetting reduction in operating expense of $28,474,765.

Colstrip 3/Black Hills Adjustment (Adjustment 5.2) – This adjustment removes Colstrip 3 and the Black Hills power sale from the revenue requirement. This treatment was authorized in Cause No. U-86-02. The effect of the adjustment is reduced revenue of $2,621,140, reduced operating expenses, property taxes and depreciation of $1,268,402 and reduced rate base of $7,812,410 including the related income tax impacts.

Incremental Coal Discount Adjustment (Adjustment 5.3) – Wyodak, Bridger, and Naughton Plants receive a discount on every ton received above a threshold amount. The cost per ton for these three plants used in the Net Power Cost Study is based on actual tons. Because the normalized tons (Net Power Cost Study) differ from the actual tons due to hydro conditions, weather conditions, system load, market price, etc., an adjustment is required to properly reflect the impact of the discount on the normalized tons. For example, if normalized tons are less than actual tons at Bridger, the number of tons above the threshold tonnage limit would be reduced. Therefore, a smaller number of tons would receive the lower cost per ton achievable above the threshold. The incremental coal discount adjustment matches the normalized tonnage level in the Net Power Cost Study with the credit that would have been received at that level. This adjustment increases Washington's allocated share of fuel expense by $338,604.

Q. Please explain the depreciation and amortization adjustments summarized under Tab 6, page 6.0.

A. **Annualized Depreciation Expense** (Adjustment 6.1) – During 1998, the Company recorded depreciation expense using rates from a 1996 depreciation study which were later reversed. Therefore, this adjustment is necessary to reflect on-going depreciation expense based on the current rates and depreciable plant balances as if the rates had never been changed during the year. The adjustment was calculated by applying the currently authorized depreciation rates to 1998 end-of-year depreciable plant balances. This annualized amount was then compared to the actual depreciation expense recorded during 1998 to determine the amount of the adjustment. Adjustment 6.1 reduces the depreciation expense allocated to Washington by $272,321 and reflects associated deferred tax effects.

Annualized Accumulated Depreciation (Adjustment 6.2) –Adjustment 6.2 is necessary to reflect the impact of Adjustment 6.1 on the accumulated depreciation reserve. Adjustment 6.2 decreases the accumulated depreciation allocated to Washington (thereby increasing rate base) by $136,161, and reflects associated deferred tax effects.

Correct Accumulated Depreciation Reserve (Adjustment 6.3) – In December 1997, PacifiCorp recorded an accounting entry to adjust depreciation expense to reflect the proposed rates from its 1996 depreciation study. That entry increased the 1997 test period depreciation expense by $15,953,898. In addition, in 1997 the Hermiston generating plant was being depreciated using a twenty-year life, rather than a thirty-five year life, thereby increasing depreciation expense by $3,565,255. On the Company’s books, the accumulated depreciation reserve is still overstated by the amount of the additional depreciation expense recorded in 1997. This adjustment reduces the amount of accumulated depreciation included in the 1998 test period rate base to reflect a balance that is consistent with the depreciation that would have been recorded using existing rates. Adjustment 6.3 reduces Washington’s allocated share of accumulated depreciation, thereby increasing rate base by the amount of $1,684,606.

Q. Please explain the interest and tax adjustments summarized under Tab 7, page 7.0.

A. **Interest True-up** (Adjustment 7.1) – Since interest expense is a cost of financing rate base through debt securities, it is appropriate to synchronize or true-up the amount of interest expense in the test period with the related amount of rate base in that test period. This true-up is accomplished by multiplying the Washington adjusted rate base for 1998 by the Company's current weighted cost of debt. The interest determined in this manner is then compared to the actual interest recorded in 1998 to determine the necessary adjustment. For ratemaking purposes, interest expense is a deduction in determining income taxes. The revenue requirement impact of the interest true-up is reflected as a change in income tax expense. Adjustment 7.1 reduces the interest expense allocated to Washington by $2,925,885, thereby increasing income tax expense by $1,117,763.

Property Tax (Adjustment 7.2) – Adjustment 7.2 is required to restate the property taxes included in the test period to a level that properly matches the test period rate base. This adjustment reflects the impact on property taxes of the sale of the Company's Montana and California service territories. No adjustment is required for the Centralia Plant sale since neither the Centralia plant investment nor its associated property tax is reflected in the results of operations report (see Tab 9). Adjustment 7.2 reduces Washington allocated property tax expense by $98,664 and reflects associated income tax impacts.

Year-end Deferred Taxes (Adjustment 7.3) – This is a Commission ordered adjustment in Cause Nos. U-86-02 and U-84-65. The adjustment brings deferred taxes to the year-end level rather than the beginning/ending average balance by decreasing the Accumulated Deferred Tax balance $1,821,000 and Unamortized ITC $101,000.

Revenue Related Tax Adjustment (Adjustment 7.4) – This adjustment reflects revenue-related taxes based on normalized revenues and the proposed rate increase of $25.8 million. This is consistent with previous Commission orders, most recently Cause No. U-86-02. Adjustment 7.4 increases expenses by $171,453 based on normalized test period revenue and includes associated income tax impacts.

Malin/Midpoint Adjustment (Adjustment 7.5) – In 1981 PacifiCorp placed a transmission line known as Malin/Midpoint into service. The Company was eligible for investment tax credits and accelerated depreciation. PacifiCorp entered into a Safe Harbor lease to transfer the tax benefits to an unrelated third party. The amount of the lease was $43,869,000. In Cause Nos. U-82-12/35 and U-83-33 the WUTC ordered the gain to be amortized over a thirty-year period with associated rate base treatment. This adjustment increases rate base $265,355 and includes corresponding income tax expense impacts. PacifiCorp proposes to end this long running adjustment believing that the benefits of the Safe Harbor lease have been fairly shared with customers over the past two decades. The Company has included the original adjustment as a Type 1, but reversed it as a Type 3 adjustment with the result being no impact on revenue requirement.

Q. Please explain the rate base adjustments summarized under Tab 8, page 8.0.

A. **Environmental Settlement** (Adjustment 8.1) – In 1996, PacifiCorp received an insurance settlement of $33 million for environmental clean-up projects. These funds were transferred to a subsidiary called PacifiCorp Environmental Remediation Company (PERCO). In 1998, PERCO received an additional $5 million of insurance proceeds. This adjustment is necessary to reflect the insurance proceeds in the test period as a reduction to rate base. The rate base credit will be reduced or amortized over time as PERCO expends dollars on clean-up costs. Adjustment 8.1 reduces Washington allocated rate base by $2,671,960.

Annualized Major Plant Additions (Adjustment 8.2) – Adjustment 8.2 annualizes the effect of putting major plant items into rate base as if the additions took place at the beginning of the test period. Only additions over $3 million are included in this adjustment. The associated changes in depreciation expense, accumulated depreciation, and taxes are reflected in Adjustments 6.1 and 6.2. Adjustment 8.2 increases Washington allocated rate base by $4,406,736 and includes an adjustment of $184,639 to reduce tax expense for the Wyoming Wind Tax Credit.

Trapper Mine Rate Base (Adjustment 8.3) – PacifiCorp owns an interest in the Trapper Mine. The Trapper Mine provides coal to the Craig generating plant. The normalized coal cost for Trapper includes all operating and maintenance costs but does not include a return on investment. This adjustment is necessary to add the Company-owned portion of Trapper Mine plant investment to rate base, since this investment is recorded in Account 123.1 – Investment in Subsidiary Company. Account 123 is not normally a rate base account. The adjustment reflects net plant rather than the actual balance in Account 123 to recognize the depreciation of the investment over time. Adjustment 8.3 increases Washington allocated rate base by $531,517.

Bridger Coal Co. Rate Base (Adjustment 8.4) – PacifiCorp owns a two-thirds interest in the Bridger Coal Company, which supplies coal to the Jim Bridger generating plant. The Company's investment in Bridger Coal Company is recorded on the books of Pacific Minerals, Inc. (PMI), a wholly-owned subsidiary. Because of this ownership arrangement, the coal mine investment is not included in electric plant in service. The normalized coal costs for Bridger Coal Company include the operating and maintenance costs of mining, but provide no return on investment. Therefore, this adjustment is necessary to properly reflect the Bridger Coal Company plant investment in test period rate base. Adjustment 8.4 increases Washington allocated rate base by $4,063,982.

Plant Held for Future Use (Adjustment 8.5) – The adjustment annualizes the write-off of steam plant related Plant Held for Future Use from the test period rate base. Adjustment 8.5 reduces Washington allocated rate base by $104,266.

Materials Allocation Correction (Adjustment 8.6) – During 1998, the costs of some storerooms associated with steam and hydro generating plants were directly assigned to the state in which they were physically located instead of being allocated system-wide. This adjustment corrects the allocation. Adjustment 8.6 reduces Washington's allocated rate base by $1,975,408.

QF Contract Buyouts (Adjustment 8.7) – Under the 1978 Public Utilities Regulatory Policy Act (PURPA), investor-owned utilities were required to purchase power from qualifying generation facilities. These contracts, which have been approved by state regulatory commissions, are known as Qualified Facilities (QF) contracts. During 1998 the Company negotiated buy-outs from two uneconomical QF contracts at less than the future required payments under the contracts. These buy-outs are being amortized over the remaining lives of the contracts. This adjustment removes out-of-period amortization expense related to 1997 for one contract, and annualizes a full year of amortization into the test period for the other. It also restates the beginning balances of both contracts to reflect a full year's amortization. Adjustment 8.7 increases Washington allocated rate base by $136,638.

Colstrip 4 AFUDC (Adjustment 8.8) – Adjustment 8.8 removes AFUDC from plant in service for the period Colstrip 4 Construction Work in Progress (CWIP) was allowed in rate base. This treatment was ordered in Cause No. U-81-17 and the adjustment incorporated in all cases since July 1984. The adjustment reduces depreciation expense by $33,000 and rate base by $305,145 along with the related income tax effects. PacifiCorp proposes discontinuing this adjustment. The impact of the adjustment on ROE is .005% and will continue to decline. Further, Colstrip has proven to be one of PacifiCorp's more cost effective resources, which is an indication that the unit has met or exceeded initial expectations and benefits to customers. After reversing the adjustment there is no effect on revenue requirement.

Update Cash Working Capital (Adjustment 8.9) – This adjustment is necessary to true-up cash working capital for the normalizing adjustments made in this filing. Cash working capital is calculated by taking total operation and maintenance expense allocated to Washington (excluding depreciation and amortization) and adding Washington's allocated share of taxes, including state and federal income taxes and taxes other than income. This total is then divided by the number of days in the year to determine the Company's adjusted daily cost of service. The daily cost of service is multiplied by the Company's net lag days to produce the cash working capital. Adjustment 8.9 reduces Washington rate base by $8,672,828.

SAP Rate Base Adjustment (Adjustment 8.10) – PacifiCorp is using the SAP R/3 software product as the technology enabling tool to implement new business process designs which have resulted in efficiencies, including sustaining the recent work force reductions that have taken place over the past year. In order to properly reflect the impact of SAP software system costs on test period revenue requirement, Adjustment 8.10 increases Washington allocated software amortization costs by $596,617, increases rate base by $3,180,846 and reflects associated deferred taxes.

Remove SERP Reserve (Adjustment 8.11) – Supplemental Executive Retirement Plan (SERP) expense is accrued each year in accordance with the actuarial report. The excess of this accrual over payouts under the plan is recorded as a liability. The SERP reserve liability account was not identified as a rate base deduction in the Company's unadjusted results. This adjustment reflects the SERP reserve as a rate base reduction. Adjustment 8.11 reduces Washington allocated rate base by $938,799.

Centralia Gain Treatment (Adjustment 8.12) – PacifiCorp proposes that the gain from the sale of the Centralia Generating Station be offset against the Yampa Project Acquisition Adjustment, with the remaining balance being amortized over the remaining life of the Yampa Project. This adjustment removes the actual Yampa amortization expense and the Yampa portion of the Miscellaneous Rate Base balance (found under Tab 15) from test period results. Included in the adjustment is the Washington portion of the average balance and amortization expense for the remaining Yampa Project Acquisition Adjustment, after the balance has been reduced by Washington's share of the Centralia gain. Adjustment 8.12 decreases Washington allocated operating expense by $366,503, decreases Washington allocated rate base by $8,958,846, and reflects associated deferred tax effects.

Remove Pension and Benefits Reserve (Adjustment 8.13) – In October 1998, a new account was set up for Pension and Benefits Reserve – Termination Pay. This account should be a rate base deduction, but it was not correctly identified in the Company's 1998 unadjusted results of operations. Adjustment 8.13 includes this new account as a rate base deduction, reducing Washington allocated rate base by $228,498.

Dave Johnston Mine Reclamation (Adjustment 8.14) – This adjustment has two components. The first component adjusts the balance of accrued reclamation costs to June 2001 levels. As reclamation work proceeds at the Dave Johnston Mine, the actual costs of reclamation will be charged against the accrued mine reclamation costs recorded in Account 253.30, reducing the balance in this account. The first component of this adjustment is necessary to restate the Account 253.30 balance to reflect the anticipated reduction. Since Account 253.30 is a rate base reduction, the effect of this reduction is to increase Washington allocated rate base by $2,102,795. The second component of this adjustment removes the net investment in the mine from unadjusted results of operations, reducing Washington allocated rate base by $1,468,113. In total, Adjustment 8.14 increases Washington allocated rate base by $634,682.

Remove Software and Hardware (Adjustment 8.15) – This adjustment removes from the test period the average rate base and depreciation/amortization expense associated with hardware and software made obsolete by the implementation of SAP software. Adjustment 8.15 reduces Washington allocated depreciation and amortization expense by $342,523 and reduces Washington allocated rate base by $502,044.

Remove Garfield Coal (Adjustment 8.16) – This adjustment removes all costs associated with Garfield mineral rights negotiations. Adjustment 8.16 reduces Washington allocated rate base by $84,009, and appropriately reflects deferred tax effects.

Q. Please explain the other adjustments summarized under Tab 9.

A. Tab 9 summarizes the removal of base period data for the Centralia Steam Plant and mine, and the sales of the California and Montana service territories. Data found under the B Tabs less the Tab 9 data will sum to the total unadjusted results found under Tab 2.

Conclusion

Q. In summary what conclusion does your testimony support?

A. My testimony demonstrates that PacifiCorp's ongoing normalized earnings in its Washington service territory are not adequate and the Company requires a price increase of $25.8 million.

Q. Does this conclude your testimony?

A. Yes.