

Exhibit No. ___T (TES-1T)

Docket No. UE-050684

Witness: Thomas E. Schooley

**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-050684

TESTIMONY OF

THOMAS E. SCHOOLEY

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

RE: PACIFICORP GENERAL RATE CASE

November 3, 2005

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	SCOPE OF TESTIMONY	2
III.	SUMMARY OF TESTIMONY	3
IV.	TEST YEAR AND RATE YEAR	5
V.	UNCONTESTED ADJUSTMENTS	7
VI.	CONTESTED ADJUSTMENTS	8
A.	Adjustment 4.10a, Wages and Benefits	8
1.	Incentive Pay Adjustments	10
a.	Annual Incentive Plan	11
b.	Long Term Incentive Plan	19
2.	Salary and Wage Increases	23
3.	Pension and Benefits Adjustment	28
a.	Pension Expense	30
b.	Medical Expenses	34
c.	Post-retirement benefits other than Pensions	38
B.	Adjustment 4.13, Scottish Power Cross Charge	40
C.	Working Capital Adjustments: Adjustment 8.1, Cash Working Capital; Adjustment 8.1a, Remove Current Assets; Adjustment 8.2, Trapper Mine Rate Base; Adjustment 8.3, Jim Bridger Mine Rate Base; and Adjustment 8.7 Dave Johnston Mine Closure	43
D.	Adjustment 8.10, Production Factor on Rate Base	51

E.	Adjustment 8.11, Remove Naches and Skookumchuck	53
F.	Adjustment 8.12, Remove Trail Mountain Mine	54
G.	Adjustment 8.13, Remove Deferred Environmental Remediation .	55
H.	Adjustment 8.14, Remove Transition Regulatory Asset	55
I.	Adjustment 8.15, New Eastside Resources Allocation.....	57
J.	Acquisition Adjustments	59
K.	Adjustments 8.16, 8.17 and 8.18, A and G Allocator	62

LIST OF EXHIBITS

- Exhibit No. ____ (TES-2): Qualifications of Thomas E. Schooley
- Exhibit No. ____ (TES-3): Revenue Requirement Presentation
- Exhibit No. ____ (TES-4): Schedule of Uncontested Adjustments
- Exhibit No. ____ (TES-5): Adjustment 4.10a, Wages and Benefits
- Exhibit No. ____ (TES-6): Adjustment 4.13, Scottish Power Cross Charge
- Exhibit No. ____ (TES-7): Investor-Supplied Working Capital
- Exhibit No. ____ (TES-8): Adjustment 8.10, Production Factor on Rate Base
- Exhibit No. ____ (TES-9): Adjustment 8.15, New Eastside Resource Allocation
- Exhibit No. ____ (TES-10): Adjustments 8.16, 8.17 and 8.18, A and G Allocator

1 I. INTRODUCTION

2

3 Q. Please state your name and business address.

4 A. My name is Thomas E. Schooley. My business address is 1300 S. Evergreen
5 Park Drive S.W., P.O. Box 47250, Olympia, WA 98504. My email address is
6 tschoole@wutc.wa.gov.

7

8 Q. By whom are you employed and in what capacity?

9 A. I am employed by the Washington Utilities and Transportation Commission
10 (the Commission) as a Regulatory Analyst.

11

12 Q. How long have you been employed by the Commission?

13 A. Since September 1991.

14

15 Q. Have you prepared an exhibit containing your qualifications?

16 A. Yes. My educational background and relevant work experience is set forth
17 in my Exhibit No. ___ (TES-2).

18

19

20

1 A. The Staff's revenue requirement analysis shows that Commission should
2 reduce PacifiCorp's revenues by \$4,189,000 annually. This represents an
3 overall decrease to revenues of 1.9%.

4 The basis for this recommendation is detailed in my Exhibit No. ____
5 (TES-3). Page 3 of that exhibit is a summary of the revenue requirements
6 calculation. The 1.9% decrease is shown on page 1 at the top of column 4.

7

8 **Q. Please explain the format of Exhibit No. ____ (TES-3).**

9 A. Staff's revenue requirement calculation begins with the Company's per
10 books results, as shown on page 1, column 1 of my exhibit. This is the same
11 starting point found in Company Witness Mr. Wrigley's Exhibit No. ____
12 (PMW-3), Tab 2.

13 Each adjustment is itemized on pages 6-21 of Exhibit No. ____ (TES-3),
14 using the same numbering system and names as the Company uses in
15 Exhibit No. ____ (PMW-3), except Staff adds adjustment numbers and names
16 for Staff's proposed adjustments.¹ New and contested adjustments are

¹ Note that on page 8 of my Exhibit No. ____ (TES-3), I present Staff Adjustment 4.10a, "Wage and Benefits Staff Adjustment." This adjustment addresses the four PacifiCorp wage adjustments: Adjustments 4.7, 4.8, 4.9, and 4.10. The Company's Adjustments 4.7 & 4.8 present the restated wages for the test period. The Company's Adjustments 4.9 & 4.10 present pro forma wages up to the rate year.

1 highlighted by shading. The uncontested adjustments are not shaded, and
2 they are also itemized on my Exhibit No. ___ (TES-4).

3 I provide a more detailed description of my Exhibit No. ___ (TES-3) in
4 the appendix on page 21 of that exhibit.

5
6 **IV. TEST YEAR AND RATE YEAR**

7
8 **Q. What is the period of time covered in Staff's analysis?**

9 A. Staff's analysis covers the twelve months ending September 2004. This
10 period is known as the test year. The results of operations for that period are
11 adjusted for known and measurable changes which may occur prior to the
12 effective date of the new rates. This period, beginning about April 2006, is
13 known as the "rate year."

14
15 **Q. Are these the same periods of time covered in PacifiCorp's direct**
16 **testimony?**

17 A. Yes.

18
19 **Q. What is the purpose of defining these two periods of time?**

1 A. A basic premise of the ratemaking process is to establish the relationship
2 between revenues, expenses, and rate base. Each of these components must
3 be measured over the same time period. Another premise is that the
4 revenues and major variable costs are both based on "normal" temperatures
5 and hydro-production conditions. To achieve consistency in presentations
6 and to assure that timely information is used, there must be agreement on a
7 recent baseline of data. That time period is the "test year."

8

9 **Q. Please explain what gives rise to the "rate year" measurement.**

10 A. Rates will be effective at a date in the near future. Therefore, it is allowable
11 to adjust the test year results to reflect known changes in the price levels,
12 assuming there are no offsetting circumstances. For example, if the
13 Company signs a new union contract after the test year, the new wage rates
14 included on that contract would be used to adjust the test year wages for
15 those employees. However, the increases are applied to the same level of
16 hours worked during the test year, unless there is a known and measurable
17 change in work levels.

18

1 decision to cover only 85% of premiums in the future, and acknowledging
2 the downward trend in medical cost increases, I propose an adjustment to
3 reduce medical expenses to reflect the 85% coverage rate and a 10% annual
4 increase in medical costs.

5 Fourth, I correct the Company's pro forma adjustment for non-union
6 salary increases to reflect the actual percentage increases the Company paid
7 after the test year.

8 Finally, I adjust the Company's pro forma costs for pension and other
9 employee benefit plans to incorporate changes in the actuarial estimates the
10 Company used to develop pro forma costs.

11
12 **Q. What is the total impact of the wage and benefit adjustments proposed by**
13 **Staff?**

14 **A.** Staff proposes a reduction to wages and benefits of \$1,148,312, which reduces
15 revenue requirements by about \$1.2 million.

16
17 **Q. Have you prepared an exhibit showing the Staff's analysis of the**
18 **Company's wage and benefits adjustments?**

19 **A.** Yes. My Exhibit No. ___ (TES-5) shows the details of Staff's analyses of these
20 adjustments, which I discuss in detail below.

1 I. *Incentive Pay Adjustments*

2

3 **Q. Please describe "incentive pay" as the term is used in this case.**

4 A. "Incentive pay" refers to compensation PacifiCorp pays to an employee if the
5 employee and/or the Company meet certain results or goals. The Company
6 specifies these goals in advance. Another term used in Company documents
7 is "at-risk" compensation, which means a portion of the employee's potential
8 salary is paid only if the established goals are achieved.

9

10 **Q. In what ways can incentive pay be paid out?**

11 A. Incentive pay may be paid out in the form of cash, or in non-cash benefits
12 such as shares of common stock.

13

14 **Q. Did PacifiCorp give compensation to its employees in the form of
15 incentive pay in the test period?**

16 A. Yes. PacifiCorp has two incentive pay plans. Under the larger of these
17 plans, the Annual Incentive Plan, PacifiCorp makes incentive payments in
18 cash. The Company's other plan is the Long Term Incentive Plan, in which
19 PacifiCorp makes incentive payments in shares of Scottish Power common
20 stock, deferred for up to a three-year period. This means the employees who

1 earn the incentive are treated as if they own the stock, but they do not receive
2 the shares for up to three years.

3
4 **Q. Please explain Staff's adjustment to incentive pay.**

5 A. Staff's adjustment removes the "at-risk" payments the Company paid based
6 on achieving certain financial parameters, or paid in the form of common
7 stock. The adjustment reduces wages and benefits by \$6,493,841 (total
8 company), or \$540,820 for Washington.

9
10 **a. Annual Incentive Plan**

11
12 **Q. Please describe PacifiCorp's Annual Incentive Plan.**

13 A. The Annual Incentive Plan is PacifiCorp's primary incentive pay plan. This
14 plan is open to all regular, full-time and part-time non-union Company
15 employees who are not participants in other incentive plans. The Annual
16 Incentive Plan is comprised of three weighted components:

17 10% PacifiCorp Scorecard Objective
18 30% Business Unit Balanced Scorecard
19 60% Individual Performance
20

1 Q. What is the "PacifiCorp Scorecard Objective?"

2 A. The PacifiCorp Scorecard Objective contains four components: Financial,
3 Stakeholder, Customer, and Employee and Process. However, awards under
4 this Objective are directly tied to an earnings test: The Company pays its
5 employees under this Objective only if the Company attains 70% or more of
6 its target Earnings Before Interest and Taxes (EBIT). If that earnings goal is
7 not met, no money is paid out under any of the components for this
8 Objective.

9

10 Q. What is the "Business Unit Balanced Scorecard?"

11 A. The Business Unit Balanced Scorecard is an incentive formula that is tailored
12 to the individual business units within the Company. PacifiCorp is
13 organized into various business units, which include both "operating"
14 business units, and business units that provide corporate and support
15 functions for the operating business units. The operating business units are
16 called Power Delivery, Generation, Commercial and Trading, and Mining.
17 For each of these business units, the Company develops goals and metrics
18 for purposes of defining incentive compensation.

1 For the business units containing corporate and support functions,
2 e.g., Legal or Human Resources, the average of the operating unit Balanced
3 Scorecards forms the basis for this award.

4 Employees in the Internal Audit and Risk/Credit Management
5 business units are eligible for awards based on 10% Scottish Power
6 Scorecard, 30% on Group Finance Balanced Scorecard, and 60% on
7 Individual Performance.

8
9 **Q. What is the "Individual Performance" component of the Annual Incentive**
10 **Plan?**

11 A. For this component, PacifiCorp establishes goals and metrics for each
12 employee that are focused on "line-of-sight" goals, *i.e.*, goals that are set
13 based on the individual employee's job description, duties and potential, as
14 well as on benefits to customers served. Awards under the Individual
15 Performance component are measured based 90% on an individual's
16 performance on their line-of-sight goals, and 10% based on their
17 performance for "Key Behaviors," which are Company-established activities
18 or attributes in areas such as "Customer Service," "Continuous
19 Improvement" and "Safety."

1 Q. What amount did the Company include in its revenue requirement for the
2 Annual Incentive Plan?

3 A. PacifiCorp included a pro forma amount of \$27,993,630 (subsequently
4 corrected to \$27,977,130), which is based on an average 50% payout of the
5 potential maximum incentive award amount. This is less than the actual
6 payout that occurred during the test year of \$43,010,583, which was based on
7 a payout of 70% of the maximum possible award.

8 The \$27,993,630 figure is shown in PacifiCorp witness Mr. Wrigley's
9 Exhibit No. ___ (PMW-3), Tab 4, page 4.10.5. The corrected amount of
10 \$27,977,130 was provided in PacifiCorp's Response to Staff Data Request No.
11 222.

12

13 Q. Is any of the Company's pro forma amount of \$27,977,130 under the
14 Annual Incentive Plan appropriate for ratemaking purposes?

15 A. Yes. Staff proposes to disallow only the portions of the pro forma award that
16 are based on meeting financial parameters and targets. For the test year, this
17 amount is \$4,162,325 on a system basis, or slightly less than 15% of the total
18 pro forma incentive pay for the test year.

19

1 **Q. How did Staff calculate this adjustment?**

2 A. Staff removed 100% of the PacifiCorp Scorecard amount, and that portion of
3 the Business Unit Scorecard amount that PacifiCorp identified as being based
4 on financial targets. Staff's calculation is shown in my Exhibit No. ___ (TES-
5 5) at 2.

6 As noted on that exhibit, Staff relied on the Company's response to
7 Staff Data Request No. 222, which segregated the total pro forma amount
8 proposed under the Annual Incentive Plan into each component – PacifiCorp
9 Scorecard Objective, Business Unit Balanced Scorecard, and Individual
10 Performance – and further segregated the PacifiCorp Scorecard and Business
11 Unit Scorecard components of the award into their separate elements –
12 Financial, Stakeholder, Customer, Employee, and Process.

13

14 **Q. Why is it appropriate to exclude for ratemaking purposes PacifiCorp's**
15 **payments to its employees that are based on financial targets?**

16 A. Incentive pay plans that are tied financial performance such as earnings
17 measures like EBIT directly benefit shareholders, so shareholders should
18 bear the cost of those plans.

19

1 Q. Is the approach you recommend consistent with Commission precedent on
2 this issue?

3 A. Yes. The Commission has disallowed incentive pay based on financial
4 targets in several rate cases.

5

6 Q. Please summarize some of these past Commission decisions regarding
7 utility bonus compensation based on meeting financial targets.

8 A. In a 1993 rate case involving Puget Sound Energy (PSE), the Commission
9 disallowed incentive awards to the extent they reflected earnings per share
10 goals. PSE argued that for one of the programs, the bonuses were associated
11 with "pay-at-risk," that is, the employee's salary, including the bonus, was
12 not above a market level. Nonetheless, the Commission ruled that
13 shareholders should pay the cost of this program.²

14 In a more recent order involving PSE, the Commission allowed
15 incentive pay expenses that were related to financial goals. However, the
16 Commission made clear that was only because there was a "second

² *WUTC v. Puget Sound Power & Light Company*, Docket Nos. UE-920433, 920499 & 921262, 11th Supplemental Order (September 21, 1993) at 61-62.

1 threshold" for the incentive payments that was based on "service quality,
2 safety and reliability considerations."³

3 By contrast, in this case, PacifiCorp's incentive payments based on
4 financial goals are separate from incentive payments based on service
5 quality, safety and reliability considerations.

6 In a rate case involving Avista Corp., the Commission disallowed
7 payments under Avista's Team Incentive Plan because they were tied to
8 corporate financial goals. According to the Commission: "Shareholders, not
9 captive ratepayers, should bear the cost of these awards. Avista's team
10 incentive awards will not be included in rates." (Citations omitted).⁴

11 In a US WEST rate case, the Commission disallowed the cost incentive
12 bonuses in US WEST's bonus plans because the incentives focused more on
13 financial goals than good customer service. The Commission relied on a
14 prior order involving Washington Natural Gas Company, in which the
15 Commission held: "Plans which do not tie payments to goals that clearly and

³ *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UG-040640, UE-040641, UE-031471 & UE-032043, Order No. 6 (February 15, 2005) at 55, ¶ 144.

⁴ *WUTC v. Avista Corp.*, Docket Nos. UE-991606 & UG-991607, 3rd Supplemental Order (September 29, 2000) at 73-74, ¶ 268-73.

1 directly benefit ratepayers will face disallowance in future proceedings.”

2 (Emphasis in text).⁵

3 The Commission also pointed out that US WEST’s plan allowed
4 bonuses to be paid when financial goals were reached, but service quality
5 goals were not: “it sends the message to employees that service quality is
6 much less important than financial performance. This provides a motivation
7 to choose cost savings measures that unduly compromise service quality.”⁶

8 In that earlier Washington Natural Gas case, the disallowed utility
9 bonus plans tied awards to earnings per share, appliance sales and programs
10 for promoting customer growth without cost control.⁷

11
12 **Q. Is Staff’s recommendation in this case consistent with these prior
13 Commission decisions regarding incentive pay?**

14 **A.** Yes. Staff applied the principles enunciated by the Commission in these
15 prior orders on this subject. Part 1 of Staff’s Adjustment 4.10a removes the
16 portions of incentive payments PacifiCorp paid based on achieving the

⁵ *WUTC v. US WEST Communications, Inc.*, Docket No. UT-950200, 15th Supplemental Order (April 11, 1996) at 48.

⁶ *Id.* at 49.

⁷ *WUTC v. Washington Natural Gas Company*, Docket No. UG-920840, 4th Supplemental Order (March 12, 1993) at 19.

1 Company's financial goals. This is shown in my Exhibit No. ___ (TES-5),
2 page 2, line 17.

3
4 **b. Long Term Incentive Plan**

5
6 **Q. Please describe the PacifiCorp's Long Term Incentive Plan.**

7 A. According to data responses from the Company, this plan rewards
8 employees with shares of Scottish Power stock rather than cash. Bonuses
9 under this Plan are available only to Company executives or upper level
10 management employees. This Plan replaced the Company's Executive Share
11 Option Plan.

12
13 **Q. How do PacifiCorp's executives and management employees qualify for
14 stock bonuses under the Long Term Incentive Plan?**

15 A. The Company awards stock to eligible employees based on the same
16 performance components as the Annual Incentive Plan.

17
18 **Q. How does PacifiCorp provide the stock bonuses to eligible employees
19 under the Long Term Incentive Plan?**

1 A. The Company buys the stock on behalf of the qualifying employees and
2 holds it for them for up to three years. This is sometimes called a “deferred
3 stock” payment. The employees who are awarded the shares of stock retain
4 voting and dividend rights. Dividends are automatically reinvested unless
5 otherwise specified.

6

7 **Q What amount did the Company include in its revenue requirement for the**
8 **Long Term Incentive Plan?**

9 A. PacifiCorp included a pro forma amount of \$2,331,516 for payments under
10 the Long Term Incentive Plan. This is shown in Tab 4, page 4.10.5 of Mr.
11 Wrigley’s Exhibit No. ___ (PMW-3).

12

13 **Q. Is any of the Company’s pro forma amount of \$2,331,516 for awards under**
14 **the Long Term Incentive Plan appropriate for ratemaking purposes?**

15 A. No. Staff recommends disallowance of 100% of the pro forma amount of the
16 Long Term Incentive Plan.

17

18 **Q. Why is it appropriate to disallow 100% of the Long Term Incentive Plan**
19 **payments for ratemaking purposes, rather than disallowing only those**
20 **portions of the award that are paid based on achieving financial targets?**

1 A. Staff's disallowance is based on the form of the award, which are shares of
2 stock. Even though all of the performance targets may not involve financial
3 targets, the form of the award is deferred stock shares, which in itself
4 provides incentives for management to maximize the price of the stock once
5 the right to the shares is received. Consequently, the form of the award itself
6 is a form of compensation based on financial incentives and results.

7 As I explained earlier, the Commission has found in numerous
8 previous cases that actions that reward shareholders are often at cross-
9 purposes with actions benefiting ratepayers. The form of this award
10 introduces a financial incentive element. Staff's adjustment recognizes this
11 element as benefiting shareholders, not ratepayers, and removes it from
12 consideration in regulated rates.

13
14 **Q. Has the Commission previously addressed the appropriate ratemaking
15 treatment of a utility's stock payments to its employees?**

16 A. Yes. In the Avista rate case I discussed earlier, the Commission allowed
17 Avista to recover in rates executive compensation in the form of restricted
18 stock. The Commission pointed to the Company's evidence that this was a
19 necessary tool in recruiting corporate executives, that it was offered by "peer

1 companies," and that it is reasonable for a Board of Directors to align the
2 utility's executive's interests with "the overall success of the company."⁸

3 However, in an earlier case, Northwest Natural Gas Company sought
4 Commission approval of a company employee stock option plan, and the
5 Commission required the costs of the stock option plan to be borne by
6 shareholders, not ratepayers:

7 The Commission believes it is appropriate in the case of stock option
8 plans to extend this condition into a prescribed standard requiring
9 that, in general rate case proceedings, adjustments will be made as
10 appropriate to assure that the costs of the stock option plan will be
11 borne by shareholders rather than ratepayers.⁹
12

13 **Q. Given that the more recent Commission decision in the Avista case you**
14 **cite supports the inclusion of stock compensation in regulated rates, why**
15 **do you oppose the approach taken in that case?**

16 **A.** The policy the Commission stated in Cause No. FR-86-142 is more consistent
17 with the Commission's overall policy on financial incentive payments. As I
18 explained above, the grant of this award in the form of deferred stock shares
19 invests it with attributes of a financial incentive.

⁸ *WUTC v. Avista Corp.*, Docket Nos. UE-991606 and UG-991607, Third Supplemental Order (September 29, 2000) at 70-71, ¶ 260.

⁹ *In re Application of Northwest Natural Gas Company*, Cause No. FR-86-142, Order Granting Application (June 18, 1987) at 6.

1 Also, in the Avista case, Avista presented extensive information in a
2 third-party salary survey regarding salaries of peer companies and
3 companies that it had to compete with to recruit executive employees. It also
4 presented testimony and evidence on the overall level of compensation for
5 its executives compared to other companies. PacifiCorp has presented no
6 such data in this case.

7 In any event, the point is not whether other companies use stock
8 compensation as a competitive tool when recruiting and retaining
9 executives, or whether it is proper for a corporation to compensate
10 executives using common stock. The issue in this case is whether captive
11 ratepayers of PacifiCorp should be required to bear the cost of a form of
12 compensation that carries with it incentives that do not benefit ratepayers.
13 Staff believes ratepayers should not be required to shoulder costs that cannot
14 be proved to benefit them. Accordingly, the Staff adjustment removes these
15 amounts, as shown on my Exhibit No. ___ (TES-5), page 2, line 21.

16
17 2. *Salary and Wage Increases*

18
19 **Q. Please describe PacifiCorp's proposed adjustments for salary and wage**
20 **increases.**

1 A. PacifiCorp proposes two types of adjustments to salaries and wages and
2 associated benefits. The first pair of adjustments annualize wage increases
3 that occurred during the test period. These are Company Adjustments 4.7
4 and 4.8. In these adjustments, PacifiCorp used base wages the Company
5 incurred during the test year ending September 30, 2004, as the basis for
6 calculating these increases.

7 In the second set of Company adjustments, Adjustments 4.9 and 4.10,
8 the Company increased expenses for the effect of scheduled wage increases
9 occurring from October 1, 2004 through March 31, 2006. In these
10 adjustments, the Company used the annualized wages calculated in
11 Adjustments 4.7 and 4.8 as the base wages for calculating pro forma
12 increases. Adjustments 4.9 and 4.10 also include changes to benefit and
13 pension accounts, which I will discuss later in my testimony.

14
15 **Q. Are any adjustments to the Company's pro forma wages appropriate?**

16 A. Yes. Two adjustments are required. One adjustment corrects the amount the
17 Company included for non-union salary increases. Staff's adjustment
18 changes the Company's estimated 3% increase to the actual levels of 2.90% in
19 May 2004, and 2.95% in May 2005.

1 This adjustment is summarized in my Exhibit No. ___ (TES-5), page 4.
2 The impact is a reduction to expense of \$200,469 system, or \$16,695
3 Washington.

4 The second adjustment normalizes test year wages and increases to
5 remove the effect of severe winter storms that occurred during the test year.
6 This adjustment reduces operating expenses on a system basis by \$278,664
7 and for Washington by \$23,208.

8

9 **Q. How did you determine that an adjustment was necessary to normalize**
10 **base wages and salaries for the effect of these winter storms?**

11 **A. In the Company's wage escalation adjustment, premium pay (for weekends**
12 **and holidays) and overtime pay for the month of January 2003 were**
13 **abnormally high compared to all other months in the test year. In addition,**
14 **the February 2003 balance of premium pay was negative. This indicated that**
15 **an adjustment or an anomaly of some kind had occurred in that time frame.**

16 In response to a Staff data request, the Company stated that these
17 anomalies were due to accruals and reversals made to recognize the costs of
18 several severe winter storms that occurred in December 2003 and January
19 2004 in Utah, Washington, and Oregon. Utah was where PacifiCorp
20 incurred most of the storm-related costs.

1

2 **Q. How did the Company treat these storm-related costs for accounting**
3 **purposes?**

4 A. According to PacifiCorp's Response to Staff Data Request No. 223, the
5 Company charged most of these storm costs against its insurance reserve.

6

7 **Q. Did the Company also adjust these storm costs out of the calculation of**
8 **base wages the Company used in calculating its wage and salary**
9 **adjustments?**

10 A. No. A review of the Company's work papers indicates that the wage
11 amounts shown in the escalation work papers (Exhibit No. ___ (PMW-3), Tab
12 4, pages 4.10.6 through 4.10.17) have not been adjusted to exclude the effect
13 of the higher costs attributable to the winter storms.

14

15 **Q. Please explain how Staff calculated its revision to the wage increases.**

16 A. The months of January and February 2004 show anomalous levels of
17 overtime and premium pay in Exhibit No. ___ (PMW-3), Tab 4, page 4.10.6.
18 Staff revised these two accounts by substituting for January and February the
19 monthly average of the other ten months of the test year. Staff then

1 recalculated the wage and salary escalations using the average "Bare Labor"
2 amounts for those two months.

3 The effect of this calculation is to remove from the calculation of
4 restated and pro forma base wages the impact of the severe storms.

5
6 **Q. Where do you calculate these wage and salary adjustments?**

7 A. Exhibit No. ___ (TES-5), page 3, calculates Staff's revisions to Company's
8 Exhibit No. ___ (PMW-3), Tab 4, pages 4.10.6 through 4.10.17. Page 3 of my
9 exhibit shows that Staff's adjustment to January and February (system basis)
10 is \$195,192 less than the Company's annualizing adjustment and \$83,472 less
11 for the pro forma wage increase adjustment. In total, Staff's adjustment
12 reduces wage increases by \$278,664.

13
14 **Q. Please explain why it is necessary to remove the storm-related expenses**
15 **from base wages.**

16 A. PacifiCorp incurred unusual amounts of overtime and premium pay to
17 repair the damages from these storms. The adjustment is necessary to
18 remove the effect of the wage and salary increases on the abnormal levels of
19 overtime and premiums for ratemaking purposes. The Company has

1 acknowledged these storms were highly unusual.¹⁰ Accordingly, the effects
2 of those storms should be removed from the payroll increase adjustments in
3 order to reflect normal conditions.

4
5 3. *Pension and Benefits Adjustment*

6
7 **Q. Does PacifiCorp propose an adjustment to test year Pensions and Benefits**
8 **expenses?**

9 A. Yes. As part of its Adjustments 4.9 and 4.10, the Company proposes pro
10 forma adjustments to pension and other benefit costs totaling \$35,228,852.
11 The largest components of this substantial increase are in: a) pension
12 expense; b) medical insurance expense; and c) post-retirement benefits other
13 than pensions. The Company's proposed adjustments to pension and benefit
14 expenses are listed on PacifiCorp Exhibit No. ___ (PMW-3), Tab 4, page
15 4.10.19.

16
17 **Q. In his testimony, PacifiCorp witness Mr. Wrigley states that pension and**
18 **employee benefit expenses have been increased to reflect the levels the**

¹⁰According to PacifiCorp's Response to WUTC Staff Data Request No. 63, "The storm...was the most destructive storm in Utah Power's recent history. ...the [Utah Center for Climate and Weather] ranks the storm as the most severe in 75 years in terms of total snowfall, precipitation and ambient temperatures."

1 **Company will incur during the rate effective period of fiscal 2006. Exhibit**
2 **No. ___T (PMW-1T) at 12. How did PacifiCorp calculate these**
3 **adjustments?**

4 A. For its pension and post-employment benefits, PacifiCorp based its
5 adjustments on fiscal year 2006 amounts from its actuarial reports. For other
6 employee benefits (medical, life insurance, 401(k) deferred compensation,
7 disability, etc.), PacifiCorp used amounts from its 2006 budget as the basis
8 for the pro forma expense expenses it proposed.

9
10 **Q. Are the 2006 budget amounts based on employee levels that are different**
11 **from the test year number of employees?**

12 A. Yes. The Company's FY 2006 budgeted levels of employee benefits are based
13 on FY 2006 estimated employee counts and future cost levels.

14
15 **Q. Does PacifiCorp include the estimated future employee counts in its pro**
16 **forma adjustments for ratemaking purposes?**

17 A. No. In this proceeding, the Company adjusted its 2006 budget amounts to
18 reflect test year employee levels. These adjustments are shown in column E
19 of Exhibit No. ___ (PMW-3), Tab 4, page 4.10.19.

1 a. **Pension Expense**

2
3 **Q. What is the Company's proposed adjustment to pension expense?**

4 A. The Company's pro forma pension cost is \$52,900,000, which is an increase of
5 \$23,238,468 over the actual test year amount. The Company's adjustment
6 uses its budget estimate for fiscal year 2006 (FY 2006) for both the PacifiCorp
7 Retirement Plan (its primary pension plan) of \$49,900,000, and a separate
8 pension plan covering IBEW union workers, in the amount of \$3,000,000.

9
10 **Q. How did PacifiCorp develop the FY 2006 pension cost estimate?**

11 A. According to the Direct Testimony of Company Witness Daniel Rosborough,
12 the Fiscal Year (FY) 2006 calculation for the PacifiCorp Retirement Plan is
13 based on costs developed in an actuarial study performed by the Company's
14 actuarial firm, Hewitt and Associates, for FY 2005. The study used data from
15 the year ended January 1, 2004, modified to incorporate more current
16 estimates for rate of return and discount rate. *Exhibit No. ___T (DJR-1T) at 3.*

17
18 **Q. Has Staff reviewed the Company's estimates?**

1 A. Yes. As part of its analysis of PacifiCorp's proposed pension cost, Staff
2 reviewed the Company's actuarial reports and its relevant responses to data
3 requests from the parties in this case.

4
5 **Q. Has PacifiCorp received updated information regarding the PacifiCorp
6 Retirement Plan costs since it filed its direct testimony?**

7 A. Yes. The Company recently received the most current Actuarial Report
8 issued by Hewitt and Associates. The report is based on data as of January 1,
9 2005, and it includes estimates of costs that apply to the Company's fiscal
10 year ending March 31, 2006.

11
12 **Q. What does the new actuarial report show?**

13 A. The report shows that the Company's pension cost attributed to electric
14 operations for FY 2006 is \$49,854,892, which is slightly less than the
15 \$49,900,000 estimate used the Company used to develop its pro forma
16 adjustment.

17
18 **Q. How does the pension expense in this case compare to the Company's
19 contributions to the pension fund, and to the pension amounts the
20 Company paid to the plan's participants for the same period?**

1 A. For the fiscal year ended March 31, 2006, the PacifiCorp total company
2 pension cost determined for the period is \$55,030,000. The Company's
3 expected employer contribution to the pension fund is \$63,707,000. The
4 Company's expected benefit payments equal \$90,000,000.

5
6 **Q. Does Staff propose an adjustment to the Company's pro forma pension
7 expense relating to the PacifiCorp Retirement Plan?**

8 A. Yes. Staff recommends that the Company's pro forma pension expense be
9 updated to the \$49,854,892 amount reflected in the Company's most recent
10 actuarial report. In this case, using the actuarially-determined accrued
11 pension expense is appropriate for inclusion in the revenue requirement,
12 because it reflects the latest known and measurable level of expense for the
13 current fiscal year. Staff accepts this as a reasonable level of expense for
14 ratemaking purposes.

15 My Exhibit No. ___ (TES-5), at 1, lines 11 and 25-27, shows this portion
16 of the wage and benefit adjustment.

17
18 **Q. What is the basis for the \$3,000,000 pro forma expense for the IBEW Local
19 57 Retirement Plan?**

1 A. According to the Direct Testimony of Mr. Rosborough, the Company has
2 included this amount because it intends to make a \$3,000,000 payment in
3 February 2006. *Exhibit No. ___T (DJR-1T) at 4.*

4
5 **Q. Is this amount consistent with this plan's expenses in previous years?**

6 A. No. According to Mr. Rosborough, PacifiCorp contributed nothing to this
7 plan in 2005 because of favorable returns in this pension fund in previous
8 years. In 2003 and 2004, however, the Company contributed \$5 million and
9 \$5.6 million, respectively, to the plan. *Id. at 6.*

10

11 **Q. What does Staff recommend with respect to the pro forma expense for the**
12 **IBEW Local 57 pension plan?**

13 A. Staff recommends that only an amount that is known and measurable be
14 allowed for this expense.

15 Mr. Rosborough's testifies that favorable investment returns would
16 prompt negotiations to determine the appropriate contribution level.

17 Therefore, continuing favorable returns for this pension fund could result in
18 no contribution being required by PacifiCorp.

19 Based on recent experience, the Company's 2005 expense for this
20 pension plan was zero. Accordingly, Staff recommends that no additional

1 test year expense be allowed for this pension plan unless the appropriate
2 amount is either actually paid by PacifiCorp, or the amount can otherwise be
3 accurately determined. The Staff adjustment removing these amounts is
4 shown in my Exhibit No. ___ (TES-5), at 1, line 13.

5
6 **b. Medical Expenses**

7
8 **Q. Please describe the Company's proposal regarding medical expenses.**

9 A. PacifiCorp proposes increases in pro forma medical expense as discussed by
10 Mr. Rosborough in Exhibit No. ___T (DJR-1T) at 7. The proposed amount for
11 medical expenses is \$43,062,629, an increase of \$5,245,913. *Exhibit No. ___*
12 *(PMW-3), Tab 4, page 4.10.19, under account 501125.*

13
14 **Q. What is the basis for the Company's estimate?**

15 A. According to the Company's Responses to Staff Data Request No. 177 and
16 Public Counsel Data Request No. 122, the Company's estimates were based
17 on payment of 90% of the cost of the medical plan, and increasing the plan
18 costs at 12% per year. The Company also assumed no change in employee
19 headcount from the test year levels.

1 Q. Are the estimates used by the Company to calculate the pro forma medical
2 expense appropriate?

3 A. No. The 90% coverage factor and the 12% increase in medical costs assumed
4 by PacifiCorp in its adjustments are not appropriate.

5
6 Q. Why is the Company's 90% coverage factor inappropriate?

7 A. Since filing this rate case, PacifiCorp has confirmed to Staff that it will reduce
8 its coverage of medical premiums from 90% to 85%. Accordingly, this
9 known and measurable change in coverage should be reflected in the
10 Company's costs for ratemaking purposes.

11

12 Q. Why is the Company's assumed 12% annual increase in medical costs
13 inappropriate?

14 A. According to PacifiCorp's Response to Public Counsel Data Request No. 122,
15 the 12% annual increase was the historical actual trend for the PacifiCorp
16 plans for calendar years 2003 and 2004.

17 However, Mr. Rosborough's Exhibit No. ____ (DJR-6) shows that
18 PacifiCorp's monthly cost per employee for its active electric operations
19 increased only 5.1% in 2003 and 8.4% in 2004.

1 In addition, Staff's review of recent medical trend information, and of
2 the changes PacifiCorp has made to its medical plans, indicates it is more
3 likely that the annual increases in the Company's medical expenses will be
4 less than the 12% the Company has experienced in recent years.

5 Accordingly, I used a 10% rate of increase in medical costs, rather than the
6 12% increase the Company used.

7
8 **Q. What changes in PacifiCorp's medical plans and recent medical trend**
9 **information justify a 10% increase rather than the 12% increase used by**
10 **PacifiCorp?**

11 **A. In his testimony, PacifiCorp witness Mr. Rosborough lists several changes**
12 **the Company has made in its medical programs and practices to mitigate its**
13 **cost increases. In the Company's Response to Staff Data Request No. 181,**
14 **PacifiCorp provided additional information on the savings the Company**
15 **expects to enjoy from the changes it has made. In that response, the**
16 **Company quantified net savings for four of the initiatives at \$1,177,000,**
17 **offset by costs of \$275,000.**

18 The Company stated it was unable to quantify the savings for several
19 of its initiatives, including the expansion of managed care plans to more
20 locations; preventive health care resulting from annual physicals; expansion

1 of educational materials and nursing advice services; and implementation of
2 a consumer driven health plan and disease management program.

3 Staff believes these changes could result in significant additional
4 savings to PacifiCorp.

5 Staff also reviewed publicly available studies and surveys regarding
6 health plan cost trends, which state that health care costs are increasing at
7 lower rates than they have in previous years. For example, a recent study by
8 the Kaiser Family Foundation concluded that premiums for job-based health
9 insurance increased 9.2 percent on average in 2005, ending four years of
10 double-digit growth in rates. The 2006 Segal Health Plan Cost Trend Survey
11 forecasts continued declines in trends in 2006. This annual survey also
12 compares actual trends to projected trends in health care costs, finding that
13 forecasts of medical cost increases are generally higher than the increases
14 actually experienced.

15 Taken as a whole, the information Staff reviewed regarding health
16 care and medical insurance cost trends indicates that the Company's use of
17 cost trends from 2003 and 2004 will likely overstate its projected medical
18 costs for the period covered by this rate case. Staff therefore recommends
19 that a lower cost trend be used to estimate pro forma medical insurance
20 premium costs for PacifiCorp

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Q. Please describe the adjustment Staff proposes to PacifiCorp's medical expenses.

A. Staff reduces the Company's expenses by \$3,117,121 (system) to reflect the change in the Company's level of coverage for its employees from 90% to 85%, and to change the rate of increase in medical costs during the pro forma period from 12% to 10%. Staff's adjustment is shown in my Exhibit No. ___ (TES-5) at 5.

c. Post-retirement benefits other than Pensions

Q. Does PacifiCorp propose other large adjustments to employee benefit costs in this case?

A. Yes. The Company proposes to include \$24,011,768 of FAS 106 post retirement benefit costs in its revenue requirement, which is a \$4,952,502 increase over the Company's actual test year expense. *Exhibit No. ___ (PMW-3), Tab 4, page 4.10.19.*

Q. Did PacifiCorp provide any testimony regarding this adjustment?

A. No.

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Q. What are FAS 106 post retirement benefits costs?

A. FAS 106 is the accounting rule pertaining to benefits other than pensions that are granted to former employees after they retire. PacifiCorp's post retirement benefits include subsidized medical and life insurance benefits to retired employees and their dependents and survivors.

Q. What is the basis for PacifiCorp's adjustment?

A. According to the Company's Response to Public Counsel Data Request No. 122, PacifiCorp based its pro forma FAS 106 expense of \$24,700,000 (total company) on an actuarial report dated January 1, 2004.

Q. Does that actuarial report contain support for the Company's pro forma FAS 106 expense in this case?

A. No. That actuarial report supported a much lower amount for FAS 106 expense than the \$24,700,000 claimed by the Company. However, in a Response to ICNU Data Request No. 3.2, the Company provided an updated actuarial report that supports a FAS 106 cost of \$24,026,898 for PacifiCorp's electric operations.

1 Q. Does Staff propose an adjustment to the FAS 106 expense PacifiCorp is
2 requesting in this case?

3 A. Yes. Staff proposes to use the updated FAS 106 amount of \$24,026,898 in
4 place of the Company's budgeted amount of \$24,700,000 in calculating the
5 pro forma FAS 106 expense. Staff's calculation is shown in Exhibit No. ____
6 (TES-5), at 1, lines 19 and 31-33. Staff's adjustment reduces PacifiCorp
7 system expenses by \$654,347 and Washington expenses by \$54,495.

8

9 B. Adjustment 4.13, Scottish Power Cross Charge

10

11 Q. Please describe this adjustment relating to the Scottish Power Cross
12 Charge.

13 A. PacifiCorp's Adjustment 4.13 concerns charges from Scottish Power to
14 PacifiCorp for corporate services. Scottish Power began charging PacifiCorp
15 for corporate services in April 2004, at the midpoint of the test year.

16 The Commission authorized this charge as an affiliated interest
17 expense in Docket No. UE-031628. PacifiCorp proposes to increase the
18 expense to the expected annual amount for the fiscal year 2005. *Exhibit No.*
19 ____ *(PMW-1T) at 13.*

20

1 Q. Are there any problems with PacifiCorp's adjustment?

2 A. There are several problems. First, PacifiCorp's adjustment is a budgeted
3 amount. As Company Witness Mr. Wrigley's states in his testimony, the
4 Company's adjustment is based on "annual expected cross charges." *Exhibit*
5 *No. ___T (PMW-1T) at 13, lines 20-21.* The Commission should not accept an
6 amount which is not known and measurable.

7 Second, there is uncertainty about the ownership of PacifiCorp on an
8 ongoing basis. The proposed acquisition of PacifiCorp by Mid-American
9 Energy is the subject of Commission Docket No. UE-051090. This potential
10 change in ownership creates uncertainty as to the appropriate level of
11 expense for corporate services of the type at issue.

12 Next, there is uncertainty regarding the amount PacifiCorp has
13 included in its adjustment. Company Witness Mr. Wrigley states that
14 "PacifiCorp is not seeking recovery of costs associated with the services
15 provided by the Strategy department and costs for the Long Term Incentive
16 Plan." *Exhibit No. ___ (PMW-1T) at 16, lines 3-4.* However, the Company's
17 Response to Staff Data Request No. 171b, shows in fact that the Company
18 included these costs.

19

1 Q. What adjustment is appropriate?

2 A. Staff recognizes the functions of the corporate headquarters may provide
3 benefits to rate payers. A representative level of expense for on-going
4 operations is the actual expense that Scottish Power charged to PacifiCorp
5 for the fiscal year ending March 2005, less the charges for the Director of
6 Group Strategy, the Strategic Planning Department, and the "Corporate SMG
7 bonus uplift." "SMG" means senior management group.

8

9 Q. Did you prepare an exhibit to calculate that adjustment?

10 A. Yes. My Exhibit No. ___ (TES-6) shows this re-calculation of the Scottish
11 Power cross charge.

12

13 Q. Please explain your Exhibit.

14 A. Line 29 shows the PacifiCorp's proposed level of cross charge, \$15,657,490,
15 which equals the amount shown in Company Exhibit No. ___ (PMW-3) at
16 Tab 4, page 4.13.1. Of this total, the line items for Director of Group Strategy,
17 Strategic Planning Dept, and Corporate SMG bonus uplift represent 4.90%,
18 3.24%, and 2.07% of the total, respectively.

19 On line 33, I show the actual charges from Scottish Power in the fiscal
20 year 2005, about \$13 million. This \$13 million in actual charges is reduced by

1 the relative percentages of the three disallowed items, for a total allowed
2 expense of \$11,684,000, shown on line 39.

3 Because Scottish Power imposed the cross-charges only during the
4 last six months of the test period, and that amounted to \$7,417,000, an
5 increase of \$4,267,000 is required to bring the system-wide total to the annual
6 level of \$11,684,000. Washington's portion of the additional \$4,267,000
7 expense is \$355,000, as seen on line 42.

8
9 **Q. What is the revenue requirement impact of your adjustment?**

10 **A. Staff's Adjustment 4.13 increases revenue requirements by \$281,000**
11 **compared to the Company's request of \$627,000.**

12
13 **C. Working Capital Adjustments: Adjustment 8.1, Cash Working Capital;**
14 **Adjustment 8.1a, Remove Current Assets; Adjustment 8.2, Trapper Mine Rate**
15 **Base; Adjustment 8.3, Jim Bridger Mine Rate Base; and Adjustment 8.7 Dave**
16 **Johnston Mine Closure**
17

18 **Q. What amounts does PacifiCorp include in its case related to working**
19 **capital?**

20 **A. PacifiCorp proposes a cash working capital increase of \$1,044,155 to its**
21 **purported "per books" working capital balance of \$3,109,343. To this**
22 **amount, PacifiCorp adds \$13,803,000 in its unadjusted rate base for**

1 "prepayments," "fuel stock," and "materials and supplies." Exhibit No. ____

2 (PMW-3) Tab 2, page 2.2, lines 42-44.

3

4 **Q. What is cash working capital?**

5 A. Cash working capital refers to the funds necessary to sustain a company in
6 its day to day operations. Accounting textbooks define working capital as
7 current assets less current liabilities.

8

9 **Q. What does PacifiCorp's balance sheet show as working capital based on**
10 **current assets less current liabilities?**

11 A. PacifiCorp's balance sheet as of September 30, 2004, shows current assets of
12 \$944,450,000 and current liabilities of \$1,594,628,000. *PacifiCorp's*
13 *Supplemental Response to Staff Data Request No. 135*. Therefore, by the simple
14 measure of current assets less current liabilities, working capital is a negative
15 \$650,178,000. This indicates that investor-supplied working capital may be
16 negative.

17

1 Q. What is the ratemaking perspective on cash working capital?

2 A. In rate setting, the goal is to determine whether investors supply working
3 capital. If they do, it is appropriate to apply a return on the amount of
4 working capital the investors supply.

5

6 Q. How has the Commission typically calculated a utility's investor supplied
7 working capital?

8 A. Over the past few decades, the Staff has advocated and the Commission has
9 accepted the use of the investor-supplied working capital (ISWC) method.

10 For example, Commission statements in prior orders include:

- 11 ○ We accept staff's working capital analysis as providing a reliable
12 measurement of the amount of working capital upon which investors
13 are entitled to earn a return.¹¹
14
- 15 ○ The Commission accepts the Commission Staff working capital
16 analysis as providing an accurate measurement of the working
17 capital upon which investors are entitled to earn a return.¹²
18
- 19 ○ The Commission accepts the Commission Staff approach (the
20 investor-supplied working capital methodology) to working capital
21 in this proceeding. The Commission believes that it is more
22 comprehensive and more accurate than the lead-lag approach. It
23 allows the calculation to take place in the context of a balance sheet

¹¹ *WUTC v. Pacific Power & Light Co.*, Cause No. U-81-17, 2nd Supplemental Order (December 16, 1981) at 5.

¹² *WUTC v. Pacific Power & Light Co.*, Cause No. U-82-12 & U-82-35, Fourth Supplemental Order (February 1, 1983) at 23.

1 analysis of company performance rather than examining limited
2 factors.¹³
3

4 **Q. Please explain the basic concept of the investor-supplied working capital**
5 **method.**

6 A. Broadly speaking, the investor-supplied working capital method measures
7 the difference between the capital invested in a business and the investments
8 in the business. In other words, investor-supplied working capital is the
9 amount of invested capital that was provided by investors and available for
10 the Company's use, over and above the company's investments in operating
11 plant, non-operating plant, and other specific items of investment.

12 If there is an excess of invested capital over investments, that amount
13 is investor-supplied working capital.

14 In summary, the investor-supplied working capital method
15 determines the amount of working capital that investors provide. If there is
16 such an amount, it is included in rate base and earns a return.

17
18 **Q. Who provides working capital besides the investor?**

¹³ *WUTC v. US West*, Docket No. UT-950200, Fifteenth Supplemental Order (April 11, 1996) at 68. Other prior cases include: *WUTC v. Pacific Northwest Bell Tel. Co.*, Cause No. U-77-87, Second Supplemental Order (October 18, 1978) at 11-12; and *WUTC v. Pacific Power & Light Co.*, Cause No. U-74-8, Second Supplemental Order (November 20, 1974) at 9-11.

1 A. Working capital is typically provided by trade creditors through the terms of
2 their payments. For example, a trade creditor may allow PacifiCorp to make
3 a payment for goods or services rendered within 30 or 60 days. The
4 Company has use of those funds during that period. Working capital may
5 also be provided by ratepayers or non-investors, via various regulatory
6 treatments, such as deferred income taxes, unamortized investment tax
7 credits, or customer deposits.

8

9 **Q. In general, how is investor-supplied working capital measured?**

10 A. As I explained, the objective is to identify the amount of investor supplied
11 funds in excess of the investments included in rate base. There are two basic
12 assumptions: 1) invested capital is first used for operating and non-operating
13 investments; and 2) the operating investments and non-operating
14 investments pro-ratably share any investor-supplied funds.

15

16 **Q. Did you prepare an exhibit that assesses PacifiCorp's working capital
17 needs on an investor-supplied basis?**

18 A. Yes. My Exhibit No. ___ (TES-7) shows this analysis.

19

1 Q. What is the result of your analysis?

2 A. My analysis shows that PacifiCorp has negative investor-supplied working
3 capital. In other words, investors are not supplying capital for the
4 Company's cash flow needs.

5

6 Q. Please explain your exhibit.

7 A. The basis for my analysis is PacifiCorp's total company balance sheet as of
8 September 30, 2004, on an average of monthly averages basis, as provided by
9 the Company in its Supplemental Response to Staff Data Request No. 135.

10 Page 1 of the exhibit shows the total invested capital on line 8. The
11 operating investments are shown on page 1 on line 58. Non-operating and
12 other investments are on page 2 at line 98 and the sum of the total
13 investments on line 100.

14 Page 2, line 102 shows the investor-supplied working capital (ISWC),
15 which is calculated by subtracting the total investments from the total
16 invested capital (line 8 less line 100). As shown on line 102, the ISWC is a
17 negative \$16,158,520.

18 The "source" column of pages 1 and 2 shows the source of the data
19 from pages 3 through 6 of my exhibit or from Exhibit No. ___(PMW-3).

20

1 Q. How does PacifiCorp calculate its cash working capital?

2 A. The Company uses a "lead-lag" method to determine its cash working
3 capital needs. In addition, as I mentioned earlier, the Company directly
4 includes in rate base separate amounts for prepayments, fuel stock, and
5 materials and supplies.

6
7 Q. Is the Company's working capital presentation appropriate?

8 A. No. In its results of operations, PacifiCorp presents "working capital" as if it
9 were an account in its books and records, which it is not. See Exhibit No. ____
10 (PMW-3) Tab 2, page 2.2, line 45. Working capital is a derived number used
11 for financial analysis. It should not be included as a direct item in rate base.

12
13 Q. Is it appropriate for the Company to include in rate base the amounts for
14 prepayments, fuel stock, and material & supplies, as shown in Company
15 Exhibit No. ____ (PMW-3) Tab 2, page 2.2, lines 42-44?

16 A. No. The accounts prepayments, fuel stock, and materials and supplies are
17 current assets, as shown in the Company's Supplemental Response to Staff
18 Data Request 135. As such, these items should only be included in working
19 capital to the extent investors supply that capital. These items should not be
20 automatically included as line item accounts as PacifiCorp presents them.

1

2 **Q. Is it appropriate to include current assets and working capital in the**
3 **results of operations?**

4 A. No. As Staff's analysis shows, PacifiCorp investors do not contribute funds
5 to working capital. Accordingly, it is appropriate to remove the Company's
6 current asset items and the "working capital" item from rate base.

7 Specifically, Staff's Adjustment 8.1a removes from rate base \$17,956,094,
8 which is the total amount of "prepayments," "fuel stock," "materials and
9 supplies," and "working capital," shown on Company Exhibit No. ____
10 (PMW-3), Tab 2, page 2.2, lines 42-45.

11

12 **Q. Do other PacifiCorp adjustments include working capital-related**
13 **components?**

14 A. Yes. Company Adjustments 8.2 (Trapper Mine Rate Base), 8.3 (Jim Bridger
15 Mine Rate Base), and 8.7 (Dave Johnston Mine Closure) each include
16 accounts which are considered current assets. Accordingly, Staff reduced
17 those adjustments by the following amounts:

18 o Adjustment 8.2, Trapper Mine Rate Base: \$47,494 for inventories and
19 prepayments, *Exhibit No. ____ (PMW-3), Tab 8, page 8.2.1;*

- 1 ○ Adjustment 8.3, Jim Bridger Mine Rate Base: \$534,735 for materials &
2 supplies, inventory, and prepayments, *Exhibit No. ___ (PMW-3), Tab 8,*
3 *page 8.3.1;*
- 4 ○ Adjustment 8.7, Dave Johnston Mine Closure: \$270,089 for “other
5 working capital,” *Exhibit No. ___ (PMW-3), Tab 8, page 8.7.*

6 These adjustments are shown in my Exhibit No. ___ (TES-3), on pages 14-17.

7

8 **D. Adjustment 8.10, Production Factor on Rate Base**

9

10 **Q. Please explain the production factor and how it is applied.**

11 A. The production factor is the ratio of test year normalized megawatt-hours
12 (MWH) to rate year MWH. PacifiCorp identifies this number as 92.8%.¹⁴

13 *Direct Testimony of Mr. Widmer, Exhibit No. ___ T(MTW-1T) at 5.*

14 The production factor is applied to the pro forma power costs and rate
15 base to bring the projected costs of the rate year back to the test year level of
16 electricity consumption. As the term implies, the production factor is only
17 applied to production or generation related expenses and rate base.

18 This method is triggered by the projection of power costs into the
19 future rate year. Those variable power costs must be matched with the

¹⁴ More specifically, the production factor is 92.759%. Mr. Widmer rounds this figure in his testimony. The testimony and exhibits also use the inverse percentage of 7.241%.

1 production facilities which generate those future megawatt-hours. However,
2 if those future costs are recovered on the lesser quantity of MWH in the test
3 year the utility will over-recover its costs.

4 The solution is to factor back the future costs by the ratio of the
5 megawatt-hours of the test year to the megawatt-hours of the rate year.

6
7 **Q. Did PacifiCorp use the production factor to determine Washington power**
8 **costs?**

9 A. In part. PacifiCorp adjusted the pro forma variable power costs by the
10 production factor. However, PacifiCorp neglected to apply the production
11 factor to the pro forma level of production rate base, associated expenses,
12 such as depreciation, and production operations and maintenance expenses.

13
14 **Q. Does Staff propose a correction to this oversight?**

15 A. Yes. PacifiCorp's Supplemental Response to Staff Data Request No. 259
16 shows its production rate base and related expenses. Staff accepts the
17 amounts in PacifiCorp's response as representative of the needed correction
18 to the Company's filed case. The results are presented in Staff's Adjustment
19 8.10 in Exhibit No. ___ (TES-3), pages 16-17 and the details are found in my
20 Exhibit No. ___ (TES-8).

1

2 **Q. What is the result of applying the corrected production factor**
3 **methodology?**

4 A. The application of the corrected production factor methodology reduces rate
5 base by approximately \$15,210,000 and increases NOI by about \$857,000.
6 Revenue requirements are reduced \$3,344,000.

7

8 **E. Adjustment 8.11, Remove Naches and Skookumchuck**

9

10 **Q. What are the Naches and Skookumchuck Hydro Projects?**

11 A. These are the small hydraulic generation plants located in Washington.
12 PacifiCorp sold these plants, and the Commission approved the transfers of
13 property in Docket Nos. UE-040202 (Skookumchuck), and UE-021118
14 (Naches).

15

16 **Q. What adjustment is appropriate for these projects?**

17 A. They should be removed from results of operations to give effect to the
18 Commission orders.

19

1 Q. What is the impact of this adjustment on revenue requirements?

2 A. This adjustment reduces expenses by \$38,000, and rate base by about
3 \$460,000. The effect on revenue requirements is a reduction of about \$97,000.

4

5 F. Adjustment 8.12, Remove Trail Mountain Mine

6

7 Q. Please explain the Staff adjustment to remove the Trail Mountain Mine.

8 A. The Trail Mountain Mine served the Company's Hunter coal-fired power
9 plants. PacifiCorp determined that the mine was uneconomic and closed it
10 in March 2001. Coal is now provided to the plant by outside sources.

11 The Company filed an accounting petition requesting the Commission
12 to authorize PacifiCorp to create as a regulatory asset the Company's cost to
13 decommission the mine. The Commission assigned the matter Docket No.
14 UE-031657. However, PacifiCorp withdrew its accounting petition on April,
15 18, 2005.

16 The Company did not have time to incorporate this item in the current
17 filing. Staff removes this regulatory asset. The effect is a reduction to rate
18 base of about \$1.5 million. This reduces revenue requirements by \$192,000.

19

1 **G. Adjustment 8.13, Remove Deferred Environmental Remediation**

2

3 **Q. Please explain Staff's adjustment to remove the Deferred Environmental**
4 **Remediation regulatory assets.**

5 A. The Commission's Order No. 1 in Docket No. UE-031658 established a set of
6 procedures for the Company to follow for capitalizing environmental
7 remediation expenses. However, the Commission issued Order No. 1 in that
8 docket on May 12, 2005. Consequently, the Company did not have time to
9 include the effect of that order in its direct case.

10 In this adjustment, Staff removes the regulatory assets per
11 Commission Order No. 1 in Docket No. UE-031658, based on the Company's
12 Response to Staff Data Request No. 226. The adjustment reduces rate base by
13 \$483,000 and increases NOI about \$87,000. Revenue requirements are
14 reduced by about \$208,000.

15

16 **H. Adjustment 8.14, Remove Transition Regulatory Asset**

17

18 **Q. Please explain what costs are involved in the Transition Regulatory Asset.**

19 A. The Transition Regulatory Asset refers to the costs that Scottish Power
20 incurred after its acquisition of PacifiCorp. Primarily, these costs consist of

1 the early retirement and severance costs Scottish Power paid to reduce the
2 labor force at PacifiCorp after the acquisition. The Commission approved
3 the Company's capitalization and amortization of these expenses in Docket
4 No. UE-000969.

5
6 **Q. What is the status of the amortization of these costs?**

7 A. According to the Company's Response to Staff Data Request No. 224, the
8 Company fully amortized the Transition Regulatory Asset in August 2005.

9
10 **Q. Did the Commission prescribe the ratemaking treatment of these costs?**

11 A. Yes. In its Order in Docket No. UE-000969, the Commission stated: "The
12 costs of the early retirement and severance programs announced during 2000
13 will not be included in rates for any years after December 31, 2005."

14
15 **Q. What is the appropriate adjustment for the Transition Regulatory Asset?**

16 A. The regulatory asset and the amortization expense should be removed from
17 the test year results of operations, both to implement the Commission's
18 order, and to recognize that the Asset has been fully amortized. The Staff
19 adjustment reduces rate base by \$2,249,000 and increases NOI by \$1,673,000.
20 PacifiCorp's revenue requirement decreases by \$3,102,000.

1

2

I. Adjustment 8.15, New Eastside Resource Allocation

3

4 **Q. Please explain Staff Adjustment 8.15, New Eastside Resource Allocation.**

5 A. Staff proposes the removal of three resources added after 2001, specifically,

6 the Gadsby Peaker Project (2002), the West Valley Lease (2002), and the

7 Currant Creek Project (2005). Staff Witness Mr. Buckley addresses the

8 reasons for this adjustment in his testimony, Exhibit No. ___T (APB-1T),

9 beginning at 162. I address the calculation of the adjustment.

10

11 **Q. How did you calculate the adjustment?**

12 A. Consistent with Mr. Buckley's testimony, Staff only removes the fixed lease

13 payments or rate base and related depreciation and taxes associated with

14 each project. Operating expenses, such as fuel and generation maintenance,

15 are not removed.

16

17 **Q. Have you prepared an exhibit showing the calculation of this adjustment**

18 **to remove these new resources?**

1 A. Yes. My Exhibit No. ___ (TES-9) identifies each of these resources, the lease
2 cost or rate base components of each, and the depreciation costs and related
3 taxes of each, to the extent these are known.

4
5 **Q. Please explain your exhibit.**

6 A. My Exhibit No. ___ (TES-9) presents only the Washington allocated portion
7 of the plants, as shown in the Company's responses to Public Counsel Data
8 Request No. 111, or in Exhibit No. ____ (PMW-3), Tab 8, pages 8.4.1-8.4.3.

9 From these data sources, I identified the fixed plant-related expenses
10 and rate base items. Lines 1 through 16 of my exhibit present the amounts
11 from each of the data sources. The footnotes identify which source was used.
12 Lines 18 through 21 are the sums of the rate base data for each plant with the
13 total in the right hand column.

14 Depreciation is the only plant-related expense removed by Staff. This
15 is shown on line 24. West Valley is an operating lease so there is no
16 PacifiCorp plant investment associated with it. PacifiCorp's fixed lease
17 payment is removed from other generation expenses. Company Witness Mr.
18 Wrigley's Exhibit No. ___ (PMW-3), Tab 8, pages 8.4.1 through 8.4.3, shows
19 the deferred income tax and IRS Schedule M impacts for the Currant Creek
20 plant. These are shown in my exhibit on line 20 and lines 29-31.

1

2 Q. What is the net effect of Staff Adjustment 8.15 to remove new Eastside
3 resources?

4 A. After applying the production factor, Staff's adjustment reduces rate base by
5 \$31,477,000 and increases NOI by \$1,714,000. The impact on revenue
6 requirements is a decrease of \$6,818,000.

7

8

J. Acquisition Adjustments

9

10 Q. Please explain the terms "acquisition adjustment" and "acquisition
11 premium."

12 A. When a utility purchases an existing plant or an entire electrical system from
13 another utility, it often pays an amount greater than the value of the plant on
14 the seller's books. Usually, the seller's net "book value" represents the
15 original purchase price of the plant, less the accumulated depreciation on
16 that asset, called "net original cost."

17

18

The amount the purchasing utility paid above net original cost is
referred to as the "acquisition premium" or "acquisition adjustment."

19

1 Q. Is an acquisition adjustment or acquisition premium generally included in
2 the acquiring utility's rate base for determining rates in Washington?

3 A. No. The Commission must approve an acquisition premium before it can be
4 included in rate base.

5
6 Q. Does PacifiCorp include acquisition adjustments in its rate base?

7 A. Yes. PacifiCorp includes a premium for the Yampa Acquisition¹⁵ in its per
8 books presentation in this case. It is shown in Mr. Wrigley's Exhibit No. ____
9 (PMW-3), Tab B15 , page 1 of 7.

10
11 Q. Has the Commission approved this acquisition adjustment?

12 A. No. In 1991, PacifiCorp sought approval for the premium it paid on the
13 Yampa Acquisition, in Docket No. UE-911186. In its January 15, 1992, Order
14 in that docket, the Commission authorized PacifiCorp "to record the
15 acquisition costs of the Colorado-Ute generating resources on its books of
16 accounts." However, the Commission further stated it "has made no
17 determination regarding the merits of the proposed acquisition or the

¹⁵ Note the terms "Yampa Acquisition" and "Colorado-Ute" are synonymous. Both refer to PacifiCorp's purchase of the Craig and Hayden generation plants.

1 amount of PacifiCorp's investment that may be included in rate base in a
2 future proceeding."

3 Since that 1991 docket, the Commission has made no definitive
4 determinations allowing PacifiCorp to recover the Colorado-Ute plants in
5 rates. However, in the Commission's Third Supplemental Order in Docket
6 No. UE-991832 (August 9, 2000), the Commission ordered the Company,
7 Staff, and other parties to review the prudence of the resources PacifiCorp
8 had acquired since 1986, PacifiCorp's prior general rate case. In the Joint
9 Report filed in compliance with that Order, Staff addressed the prudence of
10 the purchase of the Craig and Hayden plants and concluded: "Staff believes
11 that the Craig and Hayden units were acquired prudently in the sense that
12 they were intended to satisfy the system-load requirement, were low-cost,
13 and provide an added benefit through sale at a higher price."

14

15 **Q. What issues did that Joint Report leave open regarding the Yampa**
16 **Acquisition?**

17 **A.** The Joint Report still leaves open the question of the recovery of the Yampa
18 Acquisition adjustment in Washington intrastate rates.

19

1 Q. Does Staff propose an adjustment to remove certain acquisition premiums
2 from rate base?

3 A. No. To the extent that Staff's presentation is based on modifications to the
4 Revised Protocol, Staff includes the Yampa Acquisition premium in rate
5 base.

6 Should the Commission approve a Control Area Model for inter-
7 jurisdictional allocations, the plants in question and the associated
8 acquisition adjustments would fall in the Eastern Control Area and would
9 not be considered for recovery in Washington rates.

10

11 K. Adjustments 8.16, 8.17 and 8.18, A and G Allocator

12

13 Q. What are general overhead expenses?

14 A. General overhead expenses, also called administration and general expenses,
15 or "A&G" expenses, are those expenses incurred on behalf of the Company
16 as a whole, but which cannot be assigned to a particular state or function.
17 Such expenses include the president's salary, the corporate headquarters, the
18 rates department, and so on.

19

1 Q. Please describe how the Company allocates A&G expenses under the
2 Revised Protocol.

3 A. PacifiCorp's Revised Protocol allocates A&G expenses using a factor called
4 "System Overhead" (SO). The SO factor is the melded ratio of the
5 generation, transmission, intangible, and general plant as allocated to each
6 state, plus the distribution plant which is directly assigned to each state, also
7 called "situs plant." Situs plant is plant located in and serving only the
8 customers of one state; it is not allocated to any other state.

9 The Company's calculation of the SO factor is shown in Exhibit No.
10 ____ (PMW-3), Tab 10, page 10.13.

11

12 Q. Is PacifiCorp's proposed allocation of A&G expenses appropriate?

13 A. No. PacifiCorp's SO factor is heavily weighted by measures of each state's
14 share of system capacity and energy. This inappropriately allocates A&G
15 expenses. Moreover, because the SO factor is measured solely by plant, it
16 becomes problematic to use this factor in any method that allocates resources
17 and power costs based on control areas.

18

19 Q. Can you illustrate how PacifiCorp's SO factor inappropriately allocates
20 A&G expenses?

1 A. Yes. To test the propriety of the Company's A&G allocator, I did an analysis
2 which is contained in my Exhibit No. ___ (TES-10). On page 1 of that exhibit,
3 I show various data over a five year period, including number of customers,
4 net distribution plant, and energy delivery, such as System Generation,
5 System Capacity and System Energy, and the aforementioned System
6 Operations. I later explain the column labeled "3-factor Average." The
7 shaded line is data as of the end of the test year.

8 Page 1 also contains a chart showing the data in graphic form.

9

10 Q. What does the data show?

11 A. The data show that on a percentage basis, Washington's portion of the
12 Company's total customers has declined from 7.98% as of March 2001 to
13 7.60% as of March 2005. The data also show that Washington's share of
14 distribution plant has also declined over that same period, from 7.78% to
15 7.25%

16 The metrics of energy consumption show that Washington's portion
17 of the system capacity has been roughly flat, after an initial decline from 2001
18 to 2002, and our portion of system energy has stayed in a narrow range, from
19 8.42% to 8.51%.

1 However, the Company's Systems Operations (SO) factor barely
2 changes over the same five year period: from 8.23% in 2001 to 8.25% in 2005.

3
4 **Q. What is significant about virtually no change in the SO factor over that**
5 **five-year period compared to the decreases in percentage of customers,**
6 **distribution plant, and system capacity?**

7 A. It seems intuitive that the Company's A&G costs will follow each state's
8 portion of the customers, distribution plant, system capacity and system
9 energy. Yet, while Washington's share of customers, distribution plant, and
10 system capacity were less in 2005 than in 2001, the SO factor actually
11 increased, though slightly. The result is that the Company's SO factor
12 allocates relatively more A&G costs to Washington in 2005 than in 2001.

13
14 **Q. Do any of the other data you collected reflect the same problem with the**
15 **SO factor?**

16 A. Yes. Refer to the line of figures that is shaded on page 1 of my Exhibit No.
17 ____ (TES-10). As I mentioned, this line represents data from the test year
18 ending September 2004. The test year data show Washington customers
19 comprise 7.63% of PacifiCorp's total system customers, a decline from 7.98%
20 in 2001. Again, one would expect a lower allocation of A&G costs.

1 However, the Company's Systems Operations (SO) factor in the test year is
2 8.33%, an increase from the 8.23% SO factor in 2001.

3
4 **Q. What conclusions are appropriate to draw from this data?**

5 A. The data show that the SO factor used in the Revised Protocol allocates a
6 greater share of the Company's general overhead expenses when a state
7 becomes a lesser share of the Company's system. That is not an appropriate
8 result. Consequently, the Commission should not accept the Company's
9 allocation of A&G costs to Washington.

10
11 **Q. How should A&G expenses be allocated?**

12 A. A&G expenses should be allocated based on a better balance of state-specific
13 parameters than PacifiCorp uses in the Revised Protocol. An A&G allocator
14 should be more responsive to changes in shares of customers and
15 distribution plant, and less so on energy and capacity.

16 A more balanced set of parameters would be the average of three
17 measures: 1) Number of customers; 2) Amount of net distribution plant; and
18 3) Megawatts delivered as measured by the system generation factor.¹⁶

¹⁶ The System Generation (SG) factor is used frequently to allocate power costs and generation resources. The SG factor is derived by summing 75% of the System Capacity factor plus 25% of the System Energy factor.

1 This mix offers a better balance between the changes in the
2 proportions of customers and the overhead costs allocated to each state than
3 does the Company's SO factor. Moreover, these components are directly
4 measured in each state. By contrast, the Company's SO factor is based
5 heavily on allocated plant.
6

7 **Q. What is the average of the three factors Staff recommends?**

8 A. Staff's 3-factor average for the test year is 7.8617%, as shown on page 1 of my
9 Exhibit No. ____ (TES-10), in the column entitled "Staff Proposed 3-factor
10 average." The amount 7.8617% is the simple average of the three measures;
11 customers (7.6341%), net distribution plant (7.3238%), and system generation
12 (8.6273%). By comparison, the Company's SO factor for the test year is
13 8.3282%. *Exhibit No. ____ (PMW-3), Tab 10, page 10.1.*
14

15 **Q. How do the numbers and chart on page 1 of your Exhibit No. ____ (TES-10)**
16 **show that Staff's proposed A&G allocator is more appropriate than the SO**
17 **factor the Company uses from the Revised Protocol?**

18 A. Page 1 of my Exhibit No. ____ (TES-10) has a column labeled "Staff Proposed
19 3-factor average." The percentages in this column show the Staff's A&G
20 allocator for each of the time periods shown.

1 As that column shows, as the percentage of customers and net
2 distribution plant declines, so does the allocation factor. As the chart on that
3 page shows, the red "3-factor average" line follows the trend of the other data
4 better than the yellow "System Operations" factor line. On the other hand,
5 Staff's proposed 3-factor allocator remains higher than the lines for
6 customers and net distribution plant because it does recognize that
7 Washington's customers use relatively greater amounts of electricity per
8 customer than the larger PacifiCorp states.

9 Accordingly, the Staff's A&G allocator is a better factor to use than the
10 System Operations factor the Company uses in the Revised Protocol.

11
12 **Q. What is the impact on revenue requirements using the appropriate A&G**
13 **allocation factor of 7.8617%?**

14 **A.** The precise impact is difficult to calculate because the Company's SO factor
15 is used pervasively throughout the Company's ratemaking models. Despite
16 this difficulty, I estimate that applying Staff's 3-factor percentage to general
17 overhead expenses and to general plant in rate base would reduce
18 Washington's revenue requirement by about \$907,000.

19

1 Q. Is Staff proposing an adjustment for this change to the SO allocator?

2 A. Yes. The inequity of using the Company's SO factor to allocate A&G
3 expenses is too great to ignore. On pages 2 through 6 of my Exhibit No. ____
4 (TES-10), I present the calculation of Staff Adjustments 8.16 through 8.18.
5 Adjustment 8.16 calculates the adjustment to the Company's results of
6 operations; Adjustment 8.17 shows the impact on uncontested adjustments;
7 and Adjustment 8.18 shows the collective impact of Staff's proposed
8 adjustments.

9 Exhibit No. ____ (TES-10) also includes the impact of this allocation
10 change on all Company-proposed adjustments.

11

12 Q. Does this conclude your testimony?

13 A. Yes.