Exhibit No.___(JTS-1T)
Docket Nos. UE-050684/UE-050412
Witness: James Selecky

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	
Complainant,	)	**Docket No. UE-050684**
vs.	)	**Docket No. UE-050412**
PACIFICORP d/b/a PACIFIC POWER & LIGHT COMPANY	)	*(consolidated)*
Respondent.	)	

DIRECT TESTIMONY OF

JAMES T. SELECKY

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

November 3, 2005

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. James T. Selecky, 1215 Fern Ridge Parkway, Suite 208, St. Louis, MO 63141-2000.

Q. WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?

A. I am a consultant in the field of public utility regulation and a principal in the firm of Brubaker & Associates, Inc., energy, economic, and regulatory consultants.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. These are set forth in Exhibit No.___(JTS-2).

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. I am appearing on behalf of the Industrial Customers of Northwest Utilities ("ICNU"). The ICNU membership consists of industrial entities with facilities served by PacifiCorp (or the "Company").

Q. WHAT IS THE SUBJECT OF YOUR TESTIMONY?

A. My testimony will address the appropriate level of health care, pension expense, other retirement costs, ScottishPower cross charges, and incentive programs that should be included in the test year revenue requirement. In addition, I will address the treatment of the Regional Transmission Organization ("RTO") expenses and the level of state and federal income taxes that should be included in PacifiCorp's revenue requirement. My testimony and that of the other ICNU witnesses address many, but not all, of the issues raised by the Company's filing. The fact that ICNU's witnesses have not addressed an issue should not be construed as an endorsement of PacifiCorp's position. In addition, ICNU may support or adopt issues and adjustments proposed by other parties.

The following table includes the adjustments sponsored by ICNU's witnesses Randall Falkenberg, Michael Gorman, and myself:

TABLE 1

ICNU Proposed Adjustments on a Washington Jurisdictional Basis (000)

Multi-State Adjustment	$8,605
WAPA Contract	$240
Stipulated GRID Net Power Costs[1/]	$2,687
Production Factor Adjustment	$9,823
Return on Equity	$7,900
Health Care	$435
Pension Expense	$468
Post Retirement Benefit, Other Than Pension	$232
Incentive/Bonus Expense	$2,151
ScottishPower Cross Charges	$315
Consolidated Tax Adjustment	$7,967
RTO Expense	$226
Total ICNU Proposed Adjustments	**$41,049**

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

A. My adjustments reduce PacifiCorp's Washington jurisdictional revenue requirements by approximately $41 million. My recommendations are as follows:

1. PacifiCorp's test year medical costs are overstated.

2. The Washington Utilities and Transportation Commission (the "Commission") should reject PacifiCorp's proposal to escalate medical costs at 12% and should escalate those costs at 8%, which represents current projections.

1/ PacifiCorp and ICNU have entered into a net power cost stipulation ("Stipulation") that resolves certain net power cost issues that ICNU would have addressed in its direct testimony. The Stipulation reduces PacifiCorp's Washington revenue requirement by approximately $2.7 million.

3. PacifiCorp's health care costs should be adjusted to reflect a larger contribution from employees. PacifiCorp indicates that in 2005, employee contributions were 10%, while industry data indicates that employee contributions are approximately 20%.

4. Escalating PacifiCorp's medical costs at a rate of 8% and reducing these costs for a greater employee contribution lowers the total Company expense by $6.731 million, and the Washington jurisdictional revenue requirement by $435,000.

5. PacifiCorp has included in its test year revenue requirement an electric pension expense of $48.4 million on a total electric Company basis. This is significantly higher than its calendar year pension expenses in 2002 and 2003, which were $0.5 million and $14.8 million, respectively.

6. Increasing PacifiCorp's pension expense discount rate from 5.75% to 6.25% reduces the total Company basis electric pension expense by $7.250 million and the jurisdictional Washington expense by $468,000.

7. PacifiCorp's expense for post retirement benefits other than pension should be adjusted to reflect a higher discount rate.

8. The post retirement benefit other than pension expense should reflect a 6.25% discount rate. This reduces the test year post retirement benefit and other pension expense by $3.597 million on a total Company basis and the revenue requirement by $232,000 on a Washington jurisdictional basis.

9. PacifiCorp has included $15.7 million of cross charges from ScottishPower on a total Company basis in its revenue requirements.

10. A review of the cross charges from April 2004 through December 2004 indicates significant fluctuations in the monthly charges. Since the cross charges commenced in April 2004, the Commission should rely on historical data to develop the appropriate level of cross charges.

11. Utilizing the cross charges from April 2004 through December 2004 and normalizing those for a 12-month period reduces the cross charges by $3.784 million on a total Company basis and $315,000 on a Washington jurisdictional basis.

12. PacifiCorp has included in its revenue requirement $33.3 million of bonus/incentive expense on a total Company basis. PacifiCorp claims these incentive costs are necessary since base salary alone is not competitive in the market place. However, PacifiCorp's own website touts itself as having "competitive base pay." Consequently, since PacifiCorp has competitive base salaries, the additional costs associated with the incentive programs should be removed from recoverable costs.

13. PacifiCorp's proposed bonus/incentive expense should be reduced by $33.297 million on a total Company basis. This reduces the Washington jurisdictional revenue requirement by $2.151 million.

14. PacifiCorp's rates in federal and state taxes that are included in its revenue requirement are overstated.

15. The Commission should recognize in PacifiCorp's ratemaking formula the income tax benefits associated with its parent company, PacifiCorp Holdings, Inc. ("PHI"). PHI filed a consolidated tax return, which allows it to utilize its debt to reduce its federal and state income tax obligations. Since approximately 95% of the assets of PHI are related to PacifiCorp, the benefit of the PHI debt should be passed on to PacifiCorp's ratepayers.

16. Reflecting this debt in the calculation of federal and state income taxes reduces PacifiCorp's Washington jurisdictional revenue requirement by approximately $27.6 million.

17. PacifiCorp has included in its test year revenue requirement RTO costs of $2.619 million on a total Company basis. Since the RTO does not currently provide any benefits to Washington ratepayers, these costs should be excluded from PacifiCorp's test year revenue requirement.

18. Excluding the RTO costs reduces the Washington expense level by $225,949.

Q. WHAT IS THE IMPACT ON PACIFICORP'S WASHINGTON REVENUE REQUIREMENT OF THE ADJUSTMENTS THAT YOU ARE PROPOSING?

A. Table 2 below summarizes the impact of my proposed adjustments on PacifiCorp's Washington revenue requirement. I have provided the impact of my adjustments on a total Company and Washington jurisdictional basis.

TABLE 2

Summary of Revenue Requirement Adjustments
(000)

Description	Total Company	Washington Jurisdiction *
Health Care	$6,731	$435
Pension Expense	$7,250	$468
OPEB Expense	$3,597	$232
Incentive/Bonus Expense	$32,297	$2,151
ScottishPower Cross Charges	$3,784	$315
Consolidated Tax Adjustment	$97,162	$7,967
RTO Expense	$2,619	$226
Total	$153,440	$11,794

* The Washington jurisdictional revenue requirement reflects impacts on expense and capitalized costs.

I. HEALTH CARE COSTS

Q. WHAT LEVEL OF MEDICAL BENEFITS IS INCLUDED IN PACIFICORP'S REVENUE REQUIREMENT IN THIS CASE?

A. On a total Company basis, PacifiCorp has included medical insurance costs in its forecasted test year of $43.063 million.

Q. HOW DOES THE TEST YEAR PROPOSED LEVEL OF HEALTH CARE COSTS COMPARE WITH HISTORIC COSTS?

A. PacifiCorp is projecting a substantial increase in annual health care costs from historic costs to projected test year costs. Medical insurance in fiscal year ("FY") 2002, FY 2003 and FY 2004 was $29.0 million, $34.2 million, and $35.9 million, respectively.[2/] PacifiCorp is projecting a 12% annual increase from historic levels.

[2/] Exhibit No.___(JTS-9) (PacifiCorp response to ICNU data request ("DR") No. 3.8).

Q. ARE PACIFICORP'S PROJECTED INCREASES IN HEALTH CARE COSTS REASONABLE?

A. No. PacifiCorp has stated in response to ICNU DR No. 3.16 that the medical cost portion of its health care costs is expected to increase by 12% for FY 2006.[3/] The assumed medical cost escalator of 12% exceeds the expected level of increase.

Q. WHAT IS THE BASIS FOR YOUR STATEMENT THAT 12% EXCEEDS THE EXPECTED LEVEL OF INCREASE?

A. Towers Perrin, a nationally recognized consulting firm that provides services in the area of employee benefits, stated in its November/December 2004 and October 2005 publications that employer health care costs are expected to rise by 8% in 2005 and 2006. The October 2005 and 2006 publication states the following:

> U.S. companies are facing an 8% increase in their 2006 health care costs, according to the 2006 Towers Perrin health care survey of more than 200 of the largest U.S. employers. While this marks the second annual single-digit increase in a row, the health care crisis has clearly become a chronic and persistent challenge for employers and employees alike.

Therefore, 12% increase projected by PacifiCorp is inconsistent with industry data and results in overstating health care costs.

Q. HAVE PACIFICORP'S HEALTH CARE COSTS HISTORICALLY EXCEEDED NATIONAL LEVELS?

A. No. A review of industry data indicates that average increases in health care costs from 2000 to 2004 have averaged 12% to 16% per year. However, a review of PacifiCorp's data, as provided in a recent Oregon rate case, indicates that during that period, PacifiCorp's medical care costs have increased by approximately 8.8% per year. Also, PacifiCorp witness Daniel Rosborough states that PacifiCorp has experienced an increase

---

3/ Exhibit No.___(JTS-10) (PacifiCorp response to ICNU DR No. 3.16).

of 68.6% in medical costs from 1998 through 2004, while the national average for the same type of plans has increased by 75.3%.[4/]

Since PacifiCorp's health care costs have escalated at a rate below the national average over the last couple of years, it is unreasonable to expect their health care costs to increase at a rate in excess of the forecasted rate. Therefore, the Commission should utilize an 8% escalation rate to establish PacifiCorp's test year medical costs.

Q. ARE THERE OTHER FACTORS THAT SHOULD BE CONSIDERED IN ESTABLISHING THE APPROPRIATE LEVEL OF HEALTH CARE COSTS FOR PACIFICORP?

A. Yes. In the testimony of PacifiCorp witness Daniel J. Rosborough, he states that during 2004 the Company paid 91% of the total medical program costs and employees paid 9%.[5/] Mr. Rosborough also indicates that for 2005, the employees would be paying 10% of the costs of the plan.[6/] These percentages of employee contribution are significantly below industry average.

Q. WHAT PERCENTAGE OF HEALTH CARE COSTS IN GENERAL ARE EMPLOYEES REQUIRED TO PAY?

A. Based on surveys conducted by Hewitt & Associates LLC and Towers Perrin, employees are picking up approximately 20% of health care costs. Towers Perrin Monitor states the following regarding the shifting of costs to employees:

> Employers continue to shoulder the majority of the burden. Employees on average will pay $155 more in 2006, representing a 10% increase from the year before. Employers, on the other hand, will see an increase of $442 per employee, absorbing 74% of the total cost increase. Overall, employers will pay 80% of premium costs and employees will pay 20% -- roughly the same cost-sharing formula that has prevailed for the past several years among large U.S. companies.

4/ Exhibit No.___(DJR-1T) at 9.
5/ Id. at 10.
6/ Id. at 10.

Likewise, a survey performed by Hewitt & Associates LLC indicated that for 2005, the average employee would contribute approximately 20% of the health care costs.

Q. WHAT IS YOUR PROPOSAL IN THIS CASE REGARDING THE APPROPRIATE LEVEL OF HEALTH CARE COSTS THAT SHOULD BE INCLUDED IN THE COMPANY'S REVENUE REQUIREMENT?

A. The health care costs should reflect an 8% escalation rate and a 20% employee contribution. To calculate the appropriate level of health care costs, I have used PacifiCorp's test year health care costs as the starting point. I then reduced the health care costs for 18 months back to the historic period (12 months ended September 2004) using PacifiCorp's annual rate of inflation of 12% for medical costs. Next, I adjusted the medical costs to reflect an annual inflation rate of 8% and employee's contributions of 20% - not the 10% that is reflected in 2005.

These adjustments reduce PacifiCorp's 2006 health care costs on a total electric Company basis from $43.1 million to $36.3 million. The details supporting this adjustment are shown in Exhibit No.___(JTS-3).

Q. WHAT IS THE IMPACT ON PACIFICORP'S TEST YEAR EXPENSES OF YOUR PROPOSED ADJUSTMENT TO HEALTH CARE COSTS?

A. As Exhibit No.___(JTS-3) shows, I have reduced the level of health care costs on a total Company basis by $6.731 million in the test year. Utilizing the Washington allocation factor of 8.3288% and an expense allocation factor of 73.94%, PacifiCorp's health care expense included in its test year revenue requirement is reduced by $435,000.

II. PENSION EXPENSES

Q. WHAT LEVEL OF PENSION EXPENSE HAS PACIFICORP INCLUDED IN ITS FORECASTED REVENUE REQUIREMENT FOR THE TEST YEAR?

A. PacifiCorp projected a total Company electric pension expense of $48.4 million in the test year. As indicated in the testimony of PacifiCorp witness Rosborough, the test year expense represents the level of pension expense that PacifiCorp expects to incur in FY 2006 (FY 2006 ends March 31, 2006).[7/] The projection is based on actual FY 2005 expense of $31.5 million, which is the result of an actuarial calculation conducted by the Company's actuary Hewitt & Associates. PacifiCorp stated that its total Company FAS 87 pension expense for FY 2003, FY 2004 and FY 2005 was $0.5 million, $14.8 million and $31.5 million, respectively.[8/] This data not only shows that the projected FY 2006 pension expense represents a dramatic increase in pension expense, but also highlights the volatility of pension expense.

Q. WHAT ARE THE REASONS THAT PACIFICORP GIVES FOR THIS DRAMATIC INCREASE IN ITS PENSION EXPENSE?

A. PacifiCorp provides the following reasons for its estimated pension expense for FY 2006:

1. From 2000 through 2002, the pension fund experienced $450 million of asset losses, which increased the level of its projected 2006 pension expense.

2. Discount rates are at historic low levels. The FY 2004, FY 2005 and FY 2006 discount rates are 6.75%, 6.25% and 5.75%, respectively. Lowering the discount rate increases the pension expense.

These factors contributed to PacifiCorp's substantial increase in pension expense.

7/ Exhibit No.___(DJR-1T) at 3.
8/ Exhibit No.___(JTS-9).

Q. WHAT ARE THE TWO KEY FACTORS THAT CAN INFLUENCE THE PROJECTED LEVEL OF PENSION EXPENSE?

A. Two key assumptions that can influence the level of pension expense are the discount rate utilized to present value the benefits and the expected return on pension fund assets.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE LEVEL OF PENSION EXPENSE THAT SHOULD BE INCLUDED IN PACIFICORP'S RATES?

A. My recommendation in this case is to utilize as a starting point PacifiCorp's FY 2006 pension expense of $48.4 million and adjust that for an appropriate discount rate.

PacifiCorp's test year pension expense is based on a discount rate of 5.75%.[9] It is my recommendation that the amount of pension expense should be adjusted to reflect a higher discount rate. The pension expense is developed from an expected return on assets of 8.75%. This is the minimum rate that should be utilized.

Q. WOULD YOU DISCUSS WHY YOU BELIEVE IT IS APPROPRIATE TO ADJUST THE DISCOUNT RATE?

A. Yes. The discount rate that was utilized to calculate the test year pension expense is 5.75%. Increasing the discount rate reduces the pension expense accrual.

PacifiCorp's witness Dr. Hadaway projects significant increases in the interest rates. Dr. Hadaway states in his testimony that ten-year Treasury notes and long-term Treasury bonds are expected to increase from a current level of about 4.3% to 5.2%.[10] Dr. Hadaway also indicates that corporate bonds are projected to increase by 90 basis points or 0.9% over the same period of time.[11] Since the discount rate represents an interest rate, increasing the discount rate by 50 basis points to 6.25% is justifiable.

---

[9] Exhibit No.___(JTS-11) (PacifiCorp response to ICNU DR No. 3.4).
[10] Exhibit No.___(SCH-1T) at 19.
[11] Id.

Q. COULD YOU PLEASE BRIEFLY DESCRIBE HOW YOU DETERMINE THE IMPACT ON PACIFICORP'S PENSION EXPENSE OF INCREASING THE DISCOUNT RATE FROM 5.75% TO 6.25%?

A. PacifiCorp stated that an increase in the discount rate from 5.75% to 6.75% reduced the FY 2006 pension expense by $14.5 million.[12/] Therefore, I adjusted the FY 2006 pension expense of $48.36 million by $7.25 million to reflect the utilization of a higher discount rate of 6.25%. This discount rate represents a 50 basis point increase. This reduced the electric pension expense by $604,000 on a Washington jurisdictional basis.

Q. WHAT LEVEL OF RETURN ON EXPECTED ASSETS SHOULD BE UTILIZED TO DETERMINE PACIFICORP'S TEST YEAR PENSION EXPENSE?

A. An expected return on assets of 8.75% should be utilized to determine PacifiCorp's pension expense. As previously indicated, the pension expense uses an 8.75% return on expected assets.

Table 3 below shows the type of investment and the return that PacifiCorp expects to receive from those investments. As shown, its expected return is approximately 8.75%.

TABLE 3

Expected Return on Pension Assets

Type of Investment	Weighting	Expected Return	Weighted Cost
Domestic Stocks	55%	9.25%	5.09%
Bonds	35%	6.50%	2.28%
Private Holdings	10%	14.00%	1.40%
Total Return			8.77%

12/ Exhibit No.___(JTS-12) (PacifiCorp response to ICNU DR No. 3.5).

Q. ARE THERE ANY OTHER FACTORS THAT SHOULD BE CONSIDERED THAT SUPPORT USING AN EXPECTED RETURN ON ASSETS OF 8.75%?

A. Yes. In response to ICNU DR No. 3.10, PacifiCorp provided its most recent audit of PacifiCorp's Retirement Plan.[13/] The audit addressed 2002 and 2003. A review of that audit indicates that PacifiCorp has made considerable investments in limited partnership units that are more risky. These investments have incurred significant losses from their cost basis. The losses from the cost basis are approximately $40 million.[14/] These more risky investments make up approximately 11% of the total current value investments as reported in the audit. Since these investments are more risky, a higher return is warranted and a higher return should be required from these investments. Therefore, it is appropriate to reflect a higher return rate in the development of PacifiCorp's pension expense. This is captured in the return associated with "Private Holdings."

Q. WHAT IS THE TOTAL ADJUSTMENT YOU ARE PROPOSING TO PACIFICORP'S PENSION EXPENSE?

A. I am proposing that PacifiCorp's total Company electric pension expense be reduced from the projected $48.4 million contained in the rate case to $41.1 million.

III. POST RETIREMENT BENEFITS OTHER THAN PENSION

Q. DID YOU MAKE ANY ADJUSTMENTS TO THE LEVEL OF FAS 106 COSTS (POST RETIREMENT BENEFITS OTHER THAN PENSION)?

A. Yes. The adjustment I made to FAS 106 expense is similar to the adjustment I made to pension expense. That is, as a starting point I utilized the FY 2006 expense as contained in PacifiCorp's filing.[15/] I then adjusted this expense to reflect a discount rate of 6.25%. PacifiCorp indicated that the FY 2006 FAS 106 was calculated using a discount rate of

13/ Exhibit No.___(JTS-13).
14/ Id. at 33.
15/ Exhibit No.___(PMW-3) at 4.10.5.

5.75%. The reasons for adjusting the discount rate for FAS 106 are the same reasons that I outlined above in my testimony regarding pension expense.

Q. WHAT IS THE IMPACT OF YOUR PROPOSED FAS 106 ADJUSTMENTS?

A. The impact of my FAS 106 adjustments is to reduce PacifiCorp's proposed expense of $24.0 million to $20.4 million. On a jurisdictional basis, this adjustment reduces PacifiCorp's FAS 106 expense by $300,000 and its revenue requirement by $232,000. The pension and other post-retirement cost adjustments are shown on Exhibit No.___(JTS-4).

IV. CROSS CHARGE ADJUSTMENT

Q. PLEASE EXPLAIN THE CROSS CHARGE ADJUSTMENT.

A. PacifiCorp and ScottishPower executed an agreement governing the allocation of costs incurred by each entity on behalf of the other. As indicated in the testimony of Paul Wrigley, ScottishPower was providing corporate services to PacifiCorp since the merger.[16/] However, the cross charges began to be invoiced only as of April 2004.

PacifiCorp has included cross charges of $15.7 million in its test year on a total Company basis.

Q. DO YOU HAVE ANY CONCERNS ABOUT THE LEVEL OF CROSS CHARGES?

A. Yes. PacifiCorp provided ScottishPower's cross charges to PacifiCorp from April 2004 through December 2004.[17/] A review of those charges indicates that the charges fluctuate significantly monthly from a low of approximately $600,000 per month to a high of

---

16/ Exhibit No.___(PMW-1T) at 13.

17/ Exhibit No.___(JTS-14) (PacifiCorp response to ICNU DR No. 11.2).

almost $2.2 million per month. In addition, the charges provided by PacifiCorp reflect both above and below-the-line charges.

Q. WHAT IS YOUR RECOMMENDATION IN THIS PROCEEDING?

A. My recommendation is to utilize the actual 2004 charges and normalize the amount for a 12-month period and exclude any below-the-line charges that ratepayers do not have included in their cost of service below-the-line costs. The data shown in Exhibit No.___(PMW-3) at 4.13.1 indicates that 80% of the cross charges are above-the-line, while 20% are below-the-line. Therefore, I have proposed to utilize this ratio to separate above and below-the-line costs.

Q. WHAT IS THE IMPACT OF YOUR PROPOSED ADJUSTMENT TO PACIFICORP'S CROSS CHARGES?

A. My proposed adjustment reduces PacifiCorp's cross charges to $11.874 million on a total Company basis. This reduces the cross charges on a total Company basis by $3.78 million, and on a jurisdictional basis, it reduces the expenses by $315,000. The development of my adjustment is shown on Exhibit No.___ (JTS-5).

V. INCENTIVE PROGRAMS

Q. HAS PACIFICORP INCLUDED ANY COST ASSOCIATED WITH INCENTIVE PROGRAMS IN ITS TEST YEAR REVENUE REQUIREMENT?

A. Yes. PacifiCorp has included in its revenue requirement $33.297 million of incentives on a total Company basis. These incentives are identified as bonus/incentive, long-term incentive plan and incentive (performance share). These are shown on Table 4 below.

TABLE 4

Incentive Expense

Description	Amount $000
Bonus/Incentive	$2,972
Long-Term Incentive Plan	$2,332
Incentive (Performance Share)	$27,994
Total	$33,297

Q. ARE YOU PROPOSING ANY ADJUSTMENTS TO THE COMPANY'S INCENTIVE COSTS?

A. Yes. I am recommending that the Commission exclude from the Company's revenue requirement 100% of incentive costs. These costs should be excluded because PacifiCorp currently provides competitive base salaries. Incentives are not necessary in order to make PacifiCorp's total compensation package competitive in the marketplace. It is common to exclude all or a portion of incentive programs for ratemaking purposes.

Q. PLEASE DESCRIBE THESE INCENTIVE PROGRAMS.

A. PacifiCorp's long-term incentive plan is made up of deferred shares that are part of the annual incentive plan and are replacements for the Executive Share Option.[18/] This applies to 186 employees. The eligible employees are those with a competitive market level of $129,900 or higher. The Bonus/Incentives and Incentive (Performance Share) are plans that apply to over 3,000 employees.

[18/] Exhibit No.___(JTS-15) (PacifiCorp response to ICNU DR No. 11.1).

Q. WHAT IS PACIFICORP'S BASIS FOR INCLUDING INCENTIVES AS PART OF ITS LABOR COSTS?

A. As indicated in response to Public Counsel DR No. 121(c), PacifiCorp claims that incentives are a necessary component of its benefits package in order to provide competitive compensation:

> In order to attract, retain and motivate qualified employees, the Company's policy is to provide total compensation, when performance is at desired levels, which is equal to the average total compensation provided by our competitors when performance is at desired levels. Base salary alone is insufficient to provide cash compensation at a competitive level. However, at desired levels of performance, employees can earn total cash compensation that is competitive in the marketplace.[19/]

Q. ARE PACIFICORP BASE SALARIES COMPETITIVE?

A. Apparently, PacifiCorp believes they are competitive. On its website, under "Compensation & Benefits," PacifiCorp claims that its employees are awarded with "competitive base pay" and a "competitive salary."[20/] Consequently, since the Company already provides its employees competitive base pay and salaries, the claim that it needs these incentive/bonuses in order to raise total compensation to a competitive level is unwarranted. The entire amount of incentive/bonus costs should be eliminated from the costs of service.

Q. WHAT IS THE IMPACT OF YOUR PROPOSED ADJUSTMENT?

A. My proposed adjustment reduces PacifiCorp's incentive costs on a total Company basis by $33.3 million and on a Washington jurisdictional basis by $2.151 million. The details supporting the calculation are shown on my Exhibit No.__(JTS-7).

19/ Exhibit No.___(JTS-18) at 2 (PacifiCorp response to Public Counsel DR No. 121(c)) (emphasis added).
20/ See Exhibit No.___(JTS-6).

VI. CONSOLIDATED TAX ADJUSTMENT

Q. WOULD YOU PLEASE DESCRIBE THE INCOME TAX ISSUE?

A. PacifiCorp is a wholly owned subsidiary of PacifiCorp Holdings Inc. ("PHI"), which is a non-operating, direct, wholly owned subsidiary of the U.K. utility holding company ScottishPower. The PHI corporate structure was designed by ScottishPower to minimize income taxes on the taxable income of PacifiCorp and other PHI affiliates. PHI was capitalized by ScottishPower by an intercompany acquisition related loan between ScottishPower and PHI. PHI then used this loan to acquire ScottishPower shares of PacifiCorp. PHI pays interest on the acquisition loan, and deducts the interest on its income tax filings. The deduction of the interest on the acquisition loan results in a significant income tax deduction that allows PHI to avoid or significantly reduce the amount of state and federal income taxes paid on the profits generated from PacifiCorp's regulated utility operations.

Q. DOES PACIFICORP RECOGNIZE THE PHI DEBT AND THE PHI INTEREST DEDUCTION WHEN CALCULATING ITS INCOME TAXES TO INCLUDE IN ITS WASHINGTON REVENUE REQUIREMENT?

A. No. It calculates state and federal income taxes for PacifiCorp without regard to the tax deductibility of the PHI acquisition debt interest. This acquisition debt interest reduces PHI actual tax obligations and enhances PHI after tax earnings. As a result, PacifiCorp has included tax expense in its revenue requirement that will not be paid to the taxing authority. In other words, rates have been increased to cover income taxes that will never be paid.

Q. HOW LARGE OF A TAX BENEFIT IS PRODUCED BY THE PHI DEBT?

A. A Standard & Poor's ("S&P") research report on PacifiCorp states that at March 31, 2004, PHI's balance sheet contained acquisition-related debt of $2.375 billion bearing an interest rate of 6.75%.[21/] Assuming a composite state and federal tax rate of 37.95% produces tax benefit of approximately $60.8 million per year. Assuming that the loan supported only regulated activities would reduce PacifiCorp's revenue requirement by approximately $102.6 million.

Q. SHOULD THE PHI ACQUISITION-RELATED DEBT BE CONSIDERED IN DETERMINING PACIFICORP'S RETAIL REVENUE REQUIREMENT?

A. Yes. By not recognizing the interest deductibility of the PHI loan, this Commission would be asking Washington ratepayers to pay taxes that neither PacifiCorp nor ScottishPower are required to pay. The income taxes as contained in this filing ignore the existence of this tax benefit. It should be remembered that PacifiCorp's regulated ratepayers are largely supporting this loan.

Q. HAVE YOU ESTIMATED THE IMPACT THAT THIS BENEFIT HAS ON PACIFICORP'S WASHINGTON OPERATION?

A. Yes. As noted above, PHI's loan is $2.375 billion and bears an interest rate of 6.75%. This produces annual tax deductible interest expense of $160.31 million.

PacifiCorp provided the amount of buildings and other depreciable assets, land and other accumulated depreciation as of March 31, 2004, as listed on its consolidated PHI tax return.[22/] Based on that summary, regulated utility operations are entitled to 94.72% of the tax benefit. The Washington jurisdictional net plant for the test year is 8.2002% of the total Company net plant. Therefore, jurisdictional Washington customers

---

21/ Exhibit No.___(JTS-16) at 13 (PacifiCorp response to Public Counsel DR No. 6).
22/ Exhibit No.___(JTS-8) (PacifiCorp response to ICNU DR No. 3.39).

should be allocated 8.2002% of the interest expense for tax purposes. This produces approximately $12.45 million of additional tax deductions which should be reflected in Washington's jurisdictional revenue requirement.

Q. WHAT IS THE IMPACT ON THE WASHINGTON REVENUE REQUIREMENT OF RECOGNIZING THE DEDUCTIBILITY OF $12.45 MILLION OF ADDITIONAL INTEREST EXPENSE?

A. Utilizing a Washington composite tax rate of 37.95%, recognizing an additional $12.45 million of interest expense reduces Washington's tax by $4.726 million and its revenue requirement by $7.967 million.

Q. DOES YOUR ADJUSTMENT INVOLVE THE USE OF OPERATING LOSSES OF OTHER OPERATING COMPANIES OR OTHER SPECIAL DEPRECIATION OR DEPLETION DEDUCTIONS IN ORDER TO REDUCE PACIFICORP'S INCOME TAXES FOR REGULATORY PURPOSES?

A. No. The only difference between the approach that I have supported and the method that PacifiCorp put forth is the recognition of the manner in which PacifiCorp was acquired, the utilization for ratemaking purposes, and the tax benefit of the interest deduction associated with the internal loan used for this purpose. By not recognizing this interest deduction, PacifiCorp is essentially collecting from its Washington ratepayers income taxes that will never be paid.

Q. BY PROPOSING THIS ADJUSTMENT, ARE YOU RECOGNIZING ANY TAX LOSSES ASSOCIATED WITH ANY OF PHI'S NON-REGULATED SUBSIDIARIES?

A. No. My recommendation is based on PHI's tax minimization structure, which is created by the financing structure that PHI currently has in place for financing its regulated operations. The adjustment does not take into account the profits, losses or credits that result from its operations of its unregulated subsidiaries. This adjustment should not be confused with reflecting the profitability of non-regulated assets in the regulated ratemaking formula.

Q. DOES THE INTEREST DEDUCTION ASSOCIATED WITH THE LOAN USED FOR ACQUIRING PACIFICORP GIVE RISE TO DEFERRED TAXES THAT LATER REVERSE?

A. No. The interest deduction is permanent and does not give rise to deferred taxes that reverse in the future.

Q. WOULD PHI RECEIVE EXCESSIVE COMPENSATION FOR ITS INVESTMENT IN PACIFICORP IF PACIFICORP'S INCOME TAX EXPENSE IS NOT ADJUSTED TO MORE ACCURATELY REFLECT ACTUAL PAYMENTS TO TAXING AUTHORITIES?

A. Yes. PHI receives a return on its investment through PacifiCorp by receiving dividends and retaining income tax contributions that PacifiCorp makes on a standalone basis, but are not paid to taxing authorities on a PHI consolidated basis. Hence, PHI receives returns far in excess than a typical investor would normally receive from dividends and stock price appreciation. Accordingly, permitting PHI to retain income tax expense that is not ultimately paid to taxing authorities provides PHI an excessive return on its investment in PacifiCorp.

Q. SINCE RATEPAYERS DO NOT SEE THE INTEREST EXPENSE OF THE LOAN INCLUDED IN THEIR COST OF SERVICE, SHOULD THEY BENEFIT FROM THE LOWER TAX OBLIGATION?

A. Yes. The issue here is whether PacifiCorp will actually incur income tax expense and should therefore recover that expense from customers. Indeed, as S&P notes, PHI is a non-operating, wholly owned subsidiary of ScottishPower. After ScottishPower acquired PacifiCorp in 1999, it established PHI as the United States non-operating subsidiary in December 2001. ScottishPower then financed PHI to own PacifiCorp and three other non-regulated subsidiaries. Hence, PHI was formed and financed, in part, in order to minimize the income tax expense that ScottishPower would have to pay on PacifiCorp's taxable income. Importantly, the issue here is not whether customers should benefit from PHI's interest obligations, but rather the amount PacifiCorp will pay, in income tax to federal, state, and local governments. If ScottishPower has created a financing structure that will reduce or eliminate PacifiCorp's income tax expense, then PacifiCorp's rates should be adjusted to include only legitimate and known costs of providing service. Hence, my adjustment is purely based on cost of service principles.

Q. HAS ANY OTHER COMMISSION RECOGNIZED THIS TAX TREATMENT FOR RATEMAKING PURPOSES?

A. Yes. The Public Utility Commission of Oregon ("OPUC" or "Oregon Commission") entered an Order on September 28, 2005, in PacifiCorp's request for a general increase in its Oregon annual revenues in Docket No. UE 170.[23/] In that case, the Oregon Commission recognized that the interest that PHI pays to ScottishPower is deductible on PHI's consolidated income tax return. Therefore, the Oregon Commission reduced PacifiCorp's Oregon revenue requirement by $26.625 million. On a Washington jurisdictional basis, this would equal $7.69 million. The amount of this adjustment is essentially the same as my proposed tax adjustment.

Q. WHAT DID THE COMMISSION RELY ON TO MAKE ITS DECISION?

A. The Commission relied in part on Senate Bill 408 in reaching its conclusion. Essentially, that Bill authorized the Commission to set rates that reflect the taxes paid to units of the government. However, the Oregon Commission stated that it would have relied on the principle that rates should reflect taxes paid to the government even if the Oregon

[23/] Re PacifiCorp, OPUC Docket No. UE 170, Order No. 05-1050 at 16-18 (Sept. 28, 2005).

legislature did not intend for Senate Bill 408 to apply to the rate case.[24/] As indicated in the Oregon Order, this is needed for rates to be fair, just, and reasonable.

VII. RTO DEVELOPMENT COSTS

Q. HAS PACIFICORP INCLUDED ANY RTO DEVELOPMENT COSTS IN ITS TEST YEAR REVENUE REQUIREMENT?

A. Yes. On a total Company basis, PacifiCorp has included $2.619 million of RTO costs in its test year revenue requirement.[25/]

Q. DO THE RTO EXPENSES PROVIDE BENEFITS TO THE RATEPAYERS?

A. No. Currently the RTO is not operating and is not expected to be operating during the test year. As a result, the expenses associated with the development of the RTO are neither used nor useful during the test year. As a result, these costs should not be passed on to ratepayers on a current basis.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE TREATMENT OF THE RTO EXPENSES?

A. Because this expense is not providing a current benefit to ratepayers, recovery of any prudently incurred RTO costs should not occur until the RTO is operating. Therefore, the $2.619 million of RTO expenses on a total Company basis should be excluded from PacifiCorp's test year revenue requirement.

Q. WHAT IS THE IMPACT ON PACIFICORP'S WASHINGTON EXPENSES AS A RESULT OF EXCLUDING THE RTO EXPENSES?

A. Excluding the RTO expenses reduces PacifiCorp's Washington revenue requirement by $226,000. It is my recommendation that these costs should be deferred and subject to a

---

24/ See id. at 18 n.15.

25/ Exhibit No.___(JTS-17) (PacifiCorp response to ICNU DR No. 3.20).

prudency review once the RTO is operating and providing benefits to PacifiCorp's Washington ratepayers.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.