BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

EXHIBIT NO.___(RJF-9)

DIRECT TESTIMONY OF VERL R. TOPHAM

November 3, 2005

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE INVESTIGATION) OF THE REASONABLENESS OF ALLOCATION) AND THE RATES AND CHARGES FOR UTAH) POWER & LIGHT COMPANY)	Docket No. 90-035-06 PREFILED DIRECT TESTIMONY OF VERL R. TOPHAM

May 1990

Q. Please state your name, business address, and present position with PacifiCorp.

A. My name is Verl R. Topham. My business address is 1407 West North Temple St., Salt Lake City, Utah. I am President of Utah Power & Light, a division of PacifiCorp (Company). I also serve as Executive Vice President of PacifiCorp Electric Operations Group.

Q. Please outline your employment history with Utah Power & Light Company.

A. I was elected to my present position with the Company in February, 1990. I have served as Executive Vice President of PacifiCorp Electric Operations since May 1989. I also previously served as Executive Vice President of Utah Power & Light from January, 1989 to February, 1990. Previously, at Utah Power & Light Company, I was elected Vice President and Chief Financial Officer in 1981 and, in 1985, was elected Senior Vice President, Chief Financial Officer and Commercial Manager. Prior to being elected Vice President and Chief Financial Officer, I served as assistant corporate secretary and associate general counsel. Also, since 1984 I have been a member of the Board of Directors of Utah Power & Light Company.

Q. What is your educational background?

A. In 1955, I received a Bachelor of Science Degree in Law from the University of Utah. In 1960, I received a Juris Doctorate Degree in Law from the same institution.

Q. Have you previously testified in regulatory proceedings?

A. Yes. I have testified before the Public Service Commission of Utah (Commission), the Idaho Public Utility Commission, the Wyoming Public Service Commission, and the Federal Energy Regulatory Commission.

Q. Please indicate who the Company witnesses will be in this proceeding and what issues they will address.

A. In his prefiled testimony Mr. Colby will introduce the technical witnesses for the allocation issues. Mr. Gregory N. Duvall will address how net power costs would be calculated for use in determining the Company's revenue requirement if the Commission were to eliminate the Energy Balancing Account (EBA). Mr. Robert R. Dalley will sponsor an Exhibit reflecting results of operations without the EBA [UP&L Exhibit No. 3.4 (RRD-4)]. I will present the policy position of the Company requesting the elimination of the Energy Balancing Account.

Q. How is your testimony organized?

A. I will address the issue of why the EBA should be eliminated as follows:

- The EBA is not appropriate in the Company's current operating environment.
- The EBA impedes management's ability to respond to competition.
- The EBA impedes management's ability to manage the Company.
- Other reasons for elimination of the EBA.
- Proposal for termination of the EBA.

SUMMARY

Q. Mr. Topham, please briefly summarize your testimony.

A. The Company believes that the elimination of the EBA is necessary for several reasons. First, the EBA is not appropriate in the current operating environment of the merged Company. Conditions which may require a power cost adjustment (PCA) clause such as extreme volatility of fuel costs are not currently applicable to the Company. The EBA was established to address the problems of an operating environment which do not exist in the current environment. Regulatory oversight of power costs is not diminished without the EBA. It is also of interest to note that regulatory

Commissions in Arizona, Oregon, Washington, and Montana have recently terminated or denied PCA's for electric utilities subject to their jurisdiction.

Second, the EBA impedes the ability of management to respond appropriately to competition. The Company response to competition is overall stable prices. The EBA makes this policy impossible to implement because it creates price instability.

Third, the EBA impedes management's ability to manage the Company. The EBA impact of potential transactions may render an otherwise beneficial transaction unacceptable. The EBA requires full pass-through of Utah jurisdictional fuel-related net power costs. This impedes the ability of the Company to maintain stable prices by offsetting unavoidable increases in power costs with decreases or cost deferrals in non-power cost areas. The elimination of the EBA provides maximum incentive for management while providing a guaranteed level of performance for customers.

Other reasons for elimination of the EBA include, the unintended phenomenon that benefits or penalizes customers as actual retail loads fluctuate from test period loads. Additionally, the EBA raises questions about retroactive rate making.

The Company therefore proposes to set prices in the second phase of this case without the impact of the EBA. The Company proposes to terminate the EBA collection rate when prices determined in Phase II of this proceeding become effective by transferring Schedule 35 to general rate schedules. The Company proposes that if a payable balance in the EBA exists on that date, it would be returned to customers in a single lump sum distribution. Alternatively, the Company proposes that if a receivable balance exists on that date it would be held as a regulatory asset, to be dealt with in an appropriate future proceeding before this Commission.

THE EBA IS NOT APPROPRIATE TO THE COMPANY'S CURRENT OPERATING ENVIRONMENT

Q. Mr. Topham, under what conditions may a PCA be appropriate?

A. The decision to establish a PCA is a complex issue specific to a particular company. However, I believe the overriding circumstance under which such a mechanism may be appropriate is extreme volatility of power costs over a short period of time.

Q. Do you believe that the current conditions warrant a PCA for the Company?

A. No. I believe that a PCA is not appropriate to the current operating environment of the Company.

Q. Please explain.

A. In the late 1970's and early 1980's certain economic conditions prevailed which severely impacted power markets. For example, the oil embargo coupled with relatively heavy reliance on oil fired generation, as well as double digit inflation significantly impacted power costs. These conditions made forecasting fuel-related net power costs difficult for rate making purposes and contributed toward the Commission decision to establish the EBA in 1979 (See Order in case No.78-035-21, 79-035-03, pp 14 - 17, dated July 20, 1979). By contrast recent years have reflected moderate inflation, and oil prices have generally stabilized. It is therefore not surprising that this stabilized economic environment has resulted in less volatile power costs. The conditions that created the extreme volatility of power costs do not exist in the current economic environment. Therefore, the EBA is not appropriate under such economic conditions.

Q. Are you saying that power cost volatility has been eliminated in the current operating environment?

A. No. Certain power costs, by their nature are subject to weather and water conditions and other factors that are outside the control of management. Therefore they will always reflect a certain degree of volatility. However, the extreme volatility of power costs which previously prevailed has stabilized. This stability has resulted from changed economic conditions and through aggressive management of Company costs.

Q. Will regulatory oversight of power costs be diminished in the absence of the EBA?

A. No. In the absence of the EBA regulatory oversight of power costs will be accomplished principally through the Semi-Annual Results of Operations reports. These reports are intended to provide a detailed basis for the monitoring of Results of Operations between general rate cases. I anticipate that regulators will focus their attention on these reports as a mechanism to monitor overall Company performance. The regulatory oversight of power costs or any other component of results of operations should not be diminished in the least by the elimination of the EBA.

Q. What is the recent experience of other western regulatory agencies relative to PCA's?

A. For the information of the Commission, I believe it is worthy of note that electric utilities in Arizona, Montana, Oregon, and Washington have recently been denied or ordered to terminate PCA's. Additionally, no electric utility in Wyoming, Montana, Oregon, or Washington currently operates under the terms of a PCA mechanism.

Q. Prior to the merger with Utah Power, what was the experience of PacifiCorp regarding the treatment of power costs in the rate making process?

A. Pacific Power & Light jurisdictions, both prior and subsequent to the merger establish normalized power costs for rate making purposes by use of the production cost model. This model has been used for this purpose for over a decade without substantial controversy. Mr. Gregory Duvall explains the production cost model and related theory in his prefiled testimony. Additionally, it should be noted that while other utilities in jurisdictions served by Pacific Power operated under PCA mechanisms, either voluntarily or otherwise, no such mechanism was ever requested by or imposed on Pacific.

Q. Do you have other grounds on which to base your believe that the EBA is not appropriate in the current operating environment of the Company?

A. I think it is important to keep in mind that the power supply system for which the EBA was established in 1979 no longer exists. The nature of the merged Company and its operating environment are not similar to the all thermal-based system of 1979. It therefore seems inappropriate to continue to regulate and operate the Company based on a mechanism that was designed to address issues existing in 1979. I believe that if the Company was not presently operating under the terms of the EBA, the current conditions and operating environment would not require that such a clause be imposed on the Company.

THE EBA IMPEDES MANAGEMENT'S ABILITY TO RESPOND TO COMPETITION

Q. Mr. Topham, please explain the impact of competition on the Company.

A. the Company operates in an environment of ever-increasing competition from independent power producers, public power organizations, self-generators, other investor-owned utilities, as well as alternative energy sources such as natural gas, solar energy and emerging technologies. Many electric customers have more energy options today than ever before. To the extent that customers, particularly large customers, choose an alternative to Company-supplied electric energy, the Company and remaining customers are negatively impacted. Therefore, it is imperative that the Company be able to respond to competitive forces in a proactive and positive manner.

Q. What is the Company's response to competition?

A. The Company response to competition is a commitment to stable prices. Price stability implies no rapid price swings in either direction. The Company believes that price is a major factor in competitive markets, and has been pursuing strategies to maintain and/or reduce its prices for several years. These efforts demonstrate Utah Power's continuing intention to compete successfully. At the same time, the Company believes that its policy of overall price stability is in the best interest of our customers and shareholders. It will help us compete more effectively with other energy suppliers, and will provide customers some predictability about the price they will pay for electric service. It will also allow customers to effectively and efficiently make energy investment decisions for both the acquisition of equipment and the use of energy. We clearly understand that we must provide customers good service at competitive and stable prices if we are to continue to be their energy services company. Price instability simply cannot be tolerated if the Company is to remain competitive in the current operating environment. Often predictability may be as important to a customer as the absolute price, at least within a reasonable band.

Q. How does the EBA limit the ability of the Company to compete?

A. Price adjustments, when they occur should be tied to a deliberate pricing policy aimed at efficient resource use and response to given market conditions. The EBA is a regulatory mechanism which, by the nature of its operation, creates price instability divorced from pricing policy decisions. The EBA, as any balancing account, creates price fluctuations every time the associated surcharge (Schedule 35) is adjusted. This instability is contrary to the Company commitment to overall price stability and thereby inhibits the Company's ability to respond to competition.

Q. Since March, 1988, changes to the EBA collection rate have resulted in substantial price reductions. Are these price reductions consistent with the Company's response to competition?

A. The Company welcomes any opportunity to appropriately reduce customer prices. However, price reductions as a result of EBA collection rate changes are not consistent with the Company's response to competition.

Q. Please explain.

A. EBA collection rate changes are essentially outside the control of the Company. For example, if the balance in the EBA reflects an amount payable to customers, a collection rate must be implemented at a value less than anticipated fuel-related net power cost so that the balance payable can be eliminated. The reversal of that collection rate reduction when the payable balance is eliminated represents an effective price increase to customers. This price shifting is a confusing and inappropriate price signal to customers, and makes it difficult for the Company's management to manage its prices in light of our commitment to overall price stability. Additionally, the price shifts ignore efforts to correct pricing problems between classes of service and runs counter to efficient pricing policy. Therefore, EBA collection rate changes are not consistent with the Company's response to competition.

Q. How does the Company's commitment to overall price stability relate to commitments made by the Company relative to the merger of Utah Power and PacifiCorp.

A. The Company has committed to honor promises of price reductions made in conjunction with the merger. Beyond that, our commitment to stable overall prices does not and cannot reflect a specific promise. Rather, it reflects management's recognition that competitive forces require a proactive and positive response. The Company's response to competition is a commitment to maintain customer prices as stable as economic, environmental, or other conditions outside of management's control will allow.

Q. The EBA is a mechanism which places the risk of fluctuating power costs on the customer. If the EBA were terminated, the risks of fluctuating power costs would be placed on the Company. Why is the Company willing to accept this risk?

A. The Company is willing to accept this risk because we believe the risk is manageable. The Company believes in placing the risk of management practices on those that make the business decisions - management - not customers.

Additionally, the best long-term response to the threat of competition is competitive and stable prices. The EBA prevents the Company from fully implementing this strategy in the Utah jurisdiction. We simply believe that the risks to the shareholders and customers of an ineffective response to competition poses a far greater threat than the risk of fluctuating power costs.

EBA IMPEDES MANAGEMENT'S ABILITY TO MANAGE THE COMPANY

Q. Mr. Topham, how does the EBA impact the management of the Company?

A. Due in part to competition, the electric business is more dynamic today than ever before. As new or innovative types of transactions are proposed, their impact on the EBA must be considered. Additionally, any new or modified venture must always be viewed in terms of the related EBA treatment. If the EBA continues in its present form, future transactions will likely be evaluated based, at least in part, on their impact on the EBA.

Q. What is the harm in evaluating the EBA impact of potential transactions?

A. The harm is that the result of such evaluation may require the Company to reject an opportunity, otherwise beneficial to customers and shareholders, simply because of the related EBA impact. The economics of a proposed transaction should stand on their own. Decisions concerning proposed transactions should be based on economics alone, independent of the impact of the EBA.

Q. Do you have an example of such a transaction?

A. I will propose for you this scenario. The Company may be in a position to consummate an arrangement on acquiring an interest in generation facilities. Such a transaction could provide long-term benefits to customers and shareholders. In the absence of the EBA, the Company could make off system sales from the generation of this facility, and use the margin from those sales to support the Company's investment until such time as the facility was included in rate base. However, the EBA passes the Utah jurisdictional portion of secondary sales margin entirely and immediately to Utah customers through the EBA. The Company may therefore be left with limited means to offset the cost of its investment until it is included in rate base. Therefore, a transaction which makes sense economically, and which would provide long-term benefits to the Company's Utah jurisdictional customers, may be declined because of EBA considerations.

Q. Does the EBA impact Company management in other ways?

A. Yes. Tracking of any single cost item in a balancing account reduces management's ability to manage its overall business to achieve the goal of stable prices. Under the Company's proposal, in the absence of the EBA, management would have the flexibility to defer or reduce costs in one area (labor or maintenance for example), in order to offset unavoidable increases in another area (power costs for example). The Company, thereby, has the ability to hold prices stable even in periods of increasing power costs. Under current regulatory practices the EBA would require increased power costs to be reflected in prices through EBA collection rate increases. To accomplish its objective of stable prices the Company would be required to match each EBA price increase with an offsetting general price decrease. Such a scenario impedes the ability of the management to manage its business, and may further complicate the regulatory process.

Q. In the absence of the EBA, what are the implications on the incentive for management efficiency?

A. With or without the EBA, management remains committed to efficient operations. This commitment is demonstrated in part by efficiencies implemented at the Utah Power & Light coal mines which have caused coal costs to drop significantly since 1985. However, I believe that by elimination of the EBA, management is afforded maximum incentive for efficiency because the Company could be rewarded with some of the benefits of power cost efficiencies between general rate cases.

Q. In the absence of the EBA, how will customers benefit from power cost efficiencies?

A. Customers will benefit through overall stable prices. Such prices will send proper and consistent pricing signals to customers and at the same time allow customers to make energy investment decisions based on predictable prices which will not fluctuate with the operation of the EBA. Prices will be based on power costs which guarantee retail customers a certain level of power cost efficiencies whether those efficiencies are achieved or not.

OTHER REASONS FOR ELIMINATION OF THE EBA

Q. Does the EBA impact the Company when actual retail loads fluctuate from test period loads upon which prices were set?

A. Yes. The impact is based on the premise that the Company's energy resources are fixed, and that as retail loads fluctuate from test period loads, more or less of the Company's energy resources are available to make secondary sales.

Q. What is the impact on the Company when test period retail loads exceed actual loads?

A. The first impact is the obvious penalty of retail revenue loss resulting from actual load being less than the test period loads. In the absence of the EBA, this revenue loss could be at least partially offset by the additional secondary sales made with the resources not used to serve the retail load. However, the EBA requires that all revenue from secondary sales offset fuel-related net power cost in the calculation of the EBA. Therefore, under current regulatory practices the Company is penalized a second time as a result of this additional offset to the fuel-related net power cost. This situation was simply not contemplated at the inception of the EBA.

Q. What is the impact on the Company when actual retail loads exceed test period loads?

A. The benefit to the Company is symmetrical to the penalties of a retail load under-run. When retail loads exceed test period loads there is an increase in retail revenues related to the higher retail load. This higher retail load is reflected by lower secondary sales and related revenue. This creates a second benefit to the Company because secondary revenues offset fuel-related net power costs in the calculation of the EBA.

Q. What is the conclusion that you draw from this phenomenon?

A. The conclusion is that when retail loads are less than test period figures the Company suffers a double penalty. Conversely, when the retail loads are more than test period data the Company receives a benefit greater than the retail load over-run. The EBA was established to mitigate the impact on the ratemaking process of forecasting fuel-related net power costs in a volatile power market. Yet ironically, the EBA mechanism creates a phenomenon of benefit or penalty to the Company as retail loads fluctuate from test period levels. I believe the EBA should be terminated to eliminate this situation.

Q. Are there retroactive ratemaking questions raised by the EBA?

A. Yes. The application of the rule against retroactive ratemaking has been raised previously before this Commission. In 1986 the Utah Supreme Court disallowed a retroactive adjustment made to the EBA in 1982 based on the rule against retroactive ratemaking. From time to time other retroactive adjustments have been made to the EBA by way of Stipulation and/or Commission Order. None of these adjustments have been contested in the courts. It is not my intention here to draw a legal conclusion or to claim that such adjustments violate the rule against retroactive ratemaking. My purpose is to simply point out that if the EBA is not terminated, the issue of the legality of future adjustments to the EBA may require resolution.

Q. Does the issue of retroactive adjustments to the EBA present other problems for the Company?

A. Yes. The earnings impact of retroactive EBA adjustments is quite troublesome to the Company. Retroactive adjustments to the EBA have a direct impact on the current earnings of the Company. As long as the EBA is subject to retroactive adjustment, Company earnings must be considered somewhat uncertain for management purposes. This is a situation which certainly creates management uncertainty relative to the EBA and may lead to some uncertainty for users of the financial statements.

PROPOSAL FOR ELIMINATION OF EBA

Q. Mr. Topham, how does the Company propose to accomplish the termination of the EBA?

A. The first step in that process would be to file a revenue requirement in the second phase of this proceeding without the impact of the Energy Balancing Account. Simultaneously with the time prices from the second phase of this proceeding becoming effective, the current schedule 35 EBA collection rate would be terminated. The EBA collection rate would be rolled in with general tariffs that are produced from Phase II of this proceeding.

Q. What about the balance that exists in the EBA at that time?

A. Any balance payable to customers would be paid out in a one-time distribution in a manner similar to that proposed by the stipulation dated March 14, 1990 and approved by the Commission April 4, 1990 (Docket No. 90-035-03). Conversely, the Company would request that the Commission order that any balance receivable from customers, on the date of EBA termination, be established as a regulatory asset to be dealt with in an appropriate proceeding before the Commission.

Q. Mr. Topham, does this conclude your pre-filed testimony?

A. Yes, it does.