

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WUTC V. PACIFICORP D/B/A PACIFIC POWER & LIGHT COMPANY

DOCKET NOS. UE-050684 and UE-050412

SUPPLEMENTAL TESTIMONY OF DAVID J. EFFRON (DJE-6T)

ON BEHALF OF THE

PUBLIC COUNSEL SECTION

JANUARY 27, 2006

1 **Q. Please state your name.**

2 A. My name is David J. Efron.

3 **Q. Have you previously submitted testimony in this docket?**

4 A. Yes. I submitted direct testimony on November 3, 2005, marked as Exhibit No. ____
5 (DJE-1T). My professional background and qualifications are included with that
6 testimony.

7 **Q. What is the purpose of this supplemental testimony?**

8 A. Public Counsel witness Mr. Hill is presenting testimony on the Company's
9 required rate of return that recognizes the effect of parent company debt on the
10 utility operating company's cost of capital, sometimes referred to as the "double
11 leverage" method of determining the cost of capital. The purpose of this testimony
12 is to quantify the effect of the double leverage on the Company's revenue
13 requirement.

14 **Q. Have you prepared an exhibit that quantifies the effect of the double leverage
15 capital structure on the Company's revenue requirement?**

16 A. Yes. I have prepared an exhibit in the form of an updated response to Bench
17 Request No.11. That exhibit accompanies this testimony, Exhibit No. __ (DEJ-7).

18 **Q. Please summarize the effect of double leverage on the Company's revenue
19 requirement.**

20 A. The new capital structure effect included in the summary of adjustments
21 accompanying this testimony shows a reduction to the Company's revenue
22 requirement of approximately \$9.7 million. In the original response to Bench
23 Request 11, the reduction to revenue requirement related to the capital structure
24 proposed by Mr. Hill was \$3.3 million. Thus, the effect of the double leverage is to
25 reduce the Company's revenue requirement by approximately \$6.4 million (with
26 the Public Counsel rate base).

1 **Q. Have you analyzed why the double leverage reduces the Company's revenue**
2 **requirement by this amount?**

3 A. Yes. As noted by Mr. Hill, the cost of capital exclusive of the double leverage
4 effect is 7.51%, whereas with double leverage the cost of capital is 7.45%. Thus,
5 the effect of double leverage on the weighted average cost of capital itself is
6 relatively small. However, the cost of debt is deductible for state and federal
7 income tax purposes, while the cost of equity is not. The tax deduction associated
8 with the parent company interest expense allocated to the Company by means of
9 the double leverage approach reduces the Company's pro forma income tax
10 expense by \$3.5 million and its revenue requirement by \$5.9 million. Thus, it is
11 the tax deduction associated with the allocated parent company debt that accounts
12 for the great majority of the effect of the double leverage approach on the
13 Company' revenue requirement.

14 **Q. Does this conclude your supplemental testimony?**

15 A. Yes.