Exhibit No.___(JRD-1)
Docket No. UE-032065
Witness: James R. Dittmer

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION	)
	)
Complainant,	)
	)
vs.	)
	)
PACIFICORP dba Pacific Power & Light Company,	)
	)
Respondent	)

DIRECT TESTIMONY OF JAMES R. DITTMER

On Behalf of the
Public Counsel Section
Office of the Attorney General

June 2004

Q. Please state your name and address.

A. My name is James R. Dittmer. My business address is 740 Northwest Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

Q. By whom are you employed?

A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a consulting firm engaged primarily in utility rate work. The firm's engagements include review of utility rate applications on behalf of various federal, state and municipal governmental agencies as well as industrial groups. In addition to utility intervention work, the firm has been engaged to perform special studies for use in utility contract negotiations.

Q. On whose behalf are you appearing?

A. Utilitech, Inc. has been retained by the Public Counsel Section of the Office of the Attorney General of the State of Washington ("Public Counsel") to review certain aspects of the recent rate application of Pacificorp (hereinafter sometimes also referred to as "Company"). Additionally, our responsibility included the incorporation of the rate of return recommendation of Mr. Stephen Hill as well as the jurisdictional power supply adjustment sponsored by Public Counsel witness Jim Lazar. Thus, the testimony and exhibits I am presenting herein as a result of such review and analysis is offered on behalf of the Public Counsel Section of the Office of the Attorney General. I note that Mr. Hill has been jointly retained in this docket by the Public Counsel and the Staff of the Washington Utilities and Transportation Commission ("WUTC Staff" or "Commission Staff").

QUALIFICATIONS

Q. Before discussing in greater detail the issues and various recommendations that you will be addressing, please state your educational background.

A. I graduated from the University of Missouri - Columbia, with a Bachelor of Science Degree in Business Administration, with an Accounting Major, in 1975. I hold a Certified Public Accountant Certificate in the State of Missouri. I am a member of the American Institute of Certified Public Accountants and the Missouri Society of Certified Public Accountants.

Q. Please summarize your professional experience.

A. Subsequent to graduation from the University of Missouri, I accepted a position as auditor for the Missouri Public Service Commission. In 1978, I was promoted to Accounting Manager of the Kansas City Office of the Commission Staff. In that position, I was responsible for all utility audits performed in the western third of the State of Missouri. During my service with the Missouri Public Service Commission, I was involved in the audits of numerous electric, gas, water and sewer utility companies. Additionally, I was involved in numerous fuel adjustment clause audits, and played an active part in the formulation and implementation of accounting staff policies with regard to rate case audits and accounting issue presentations in Missouri. In 1979, I left the Missouri Public Service Commission to start my own consulting business. From 1979 through 1985 I practiced as an independent regulatory utility consultant. In 1985, Dittmer, Brosch and Associates was organized. Dittmer, Brosch and Associates, Inc. changed its name to Utilitech, Inc. in 1992.

My professional experience since leaving the Missouri Public Service Commission has consisted primarily of issues associated with utility rate, contract and acquisition matters. For the past twenty-five years, I have appeared on behalf of clients in utility rate proceedings before various federal and state regulatory agencies. In representing those clients, I performed revenue requirement studies for electric, gas, water and sewer utilities and testified as an expert witness on a variety of rate matters. As a consultant, I have filed testimony on behalf of industrial consumers, consumer groups, the Missouri Office of the Public Counsel, the Missouri Public Service Commission Staff, the Indiana Utility Consumer Counselor, the Mississippi Public Service Commission Staff, the Arizona Corporation Commission Staff, the Arizona Residential Utility Consumer Office, the Nevada Office of the Consumer Advocate, the Washington Attorney General's Office, the Hawaii Consumer Advocate's Staff, the Oklahoma Attorney General's Office, the West Virginia Public Service Commission Consumer Advocate's Staff, municipalities and the Federal government before regulatory agencies in the states of Arizona, Alaska, Maine, Michigan, Missouri, Oklahoma, Ohio, Florida, Colorado, Hawaii, Iowa, Kansas, Mississippi, New Mexico, Nevada, New York, West Virginia, Washington and Indiana, as well as the Federal Energy Regulatory Commission.

Exhibit Organization and Sponsorship

Q. Have you prepared schedules which summarize the adjustments and positions being sponsored by you and other Public Counsel witnesses?

A. Yes. I have attached schedules which reflect the cost of capital recommendations sponsored by Mr. Stephen Hill, the interstate allocation of power production costs adjustment sponsored by Mr. Jim Lazar, as well as the miscellaneous rate base and income statement adjustments that I am sponsoring.

Q. Please explain how your schedules are organized.

A. I would first note that my starting point is the Company's "as adjusted" Washington jurisdictional revenue requirement calculation. Schedule A is the Revenue Requirement Summary, which reflects the cumulative impact of the various revenue, operating expense, rate base and cost of capital recommendations being sponsored by Mr. Hill, Mr. Lazar and me. Exhibit _____, JRD-2. Also shown on Schedule A are the values of the various components underlying the Company's revenue requirement recommendation which were developed utilizing Company-proposed "as adjusted" Washington jurisdictional operating results and rate base. Thus, one can observe on a summary level basis how the various components of Public Counsel's revenue requirement recommendation contrasts with that being proposed by Pacificorp.

Schedule B is the Rate Base Summary. Exhibit _____, JRD-3. In developing Public Counsel's proposed retail rate base I have started by showing Pacificorp's proposed jurisdictional rate base by detailed component (i.e., Column b). Columns (c) through (f) of Schedule B show Public Counsel's individual rate base adjustments. Immediately following Schedule B – Rate Base Summary are a number of supporting schedules which set forth each individual Public Counsel rate base adjustment. Each individual rate base adjustment has a separate designation such as B-1, B-2, etc. Thus, each rate base adjustment identified and presented with a separate "B Schedule" designation becomes a reconciling item between Pacificorp's and Public Counsel's rate base recommendation.[1]

Schedule C is the Net Operating Income Summary. Exhibit _____, JRD-8. In a manner similar to the rate base schedules, I begin on Schedule C by showing the Company's "proposed" or "as adjusted" net operating income by major component. The individual Public Counsel adjustments to net operating income can be found in Columns (c) through (h) of Schedule C, with the support for each income statement adjustment developed on separate schedules. Thus, like the rate base schedules, each "C Schedule" reflects a reconciling component or adjustment between Pacificorp's proposed net operating income and Public Counsel's proposed net operating income.[2] Through the remainder of my testimony I will use the terms "Adjustment

[1] Schedule B-1 is Exhibit _____, JRD-4; B-2 is Exhibit ______, JRD-5; B-3 is Exhibit _____, JRD-6, and B-4 is Exhibit _____, JRD-7.
[2] Schedule C-1 is Exhibit _____, JRD-9; C-2 is Exhibit _____, JRD-10, and C-3 is Exhibit _____, JRD-11.

B-__" and "Schedule B-__" as well as "Adjustment C-__" and "Schedule C-__" interchangeably.

Schedule D reflects the Company's as well as the Public Counsel's proposed capital structure, including the weighted cost of debt, preferred stock and recommended return on equity. Exhibit _____, JRD-12. As previously noted, Public Counsel's proposed capital structure and component cost recommendations are sponsored by Mr. Stephen Hill on behalf of Public Counsel and Commission Staff.

Q. Where has Mr. Lazar's production cost adjustment been reflected?

A. As Mr. Lazar explains in his direct testimony, he has developed his adjustment by considering hydro costs on a situs basis – which considers both return and operating costs of production facilities located in Washington. The "net" adjustment of excluding Pacificorp's total-system-allocated cost to Washington versus Mr. Lazar's proposed Washington-specific assignment of production costs is captured on line 13 of Schedule A. As noted, it is a "net" adjustment which considers and captures the net change in production costs (return and operating expense less any off-system sales margin difference) on a Washington jurisdictional basis.

Q. There are only a limited number of rate base and income statement adjustments posted on the schedules you have attached. Did you and other Public Counsel witnesses undertake a comprehensive review of Pacificorp's rate application?

A. No. Resource constraints prohibited a comprehensive review of all potential issue areas. Accordingly, the number of areas reviewed, and issue areas being addressed, has been limited. The fact that no adjustment may have been posted for a given area should not be construed to mean that Public Counsel is in agreement with a given rate base, revenue or expense level being proposed by Pacificorp. Public Counsel will likely advocate other positions in hearings and briefs beyond those being addressed by Public Counsel witnesses in prefiled written testimony.

Customer Deposits

Q. Please discuss your first adjustment to Pacificorp's proposed Washington jurisdictional rate base.

A. As shown on Schedule B-1, I am proposing to reduce Pacificorp's rate base by the average test-year balance of Washington jurisdictional Customer Deposits. Customer Deposits help finance Pacificorp's various utility investments included within rate base determination. The current interest rate being paid on Washington jurisdictional Customer Deposits is only 1.18%. Response to Public Counsel Data Request No. 85. Thus, such funds represent a very inexpensive source for financing. Accordingly, ratepayers should be given credit for such low cost source of funds in the rate making process.

As shown on Schedule B-1, in addition to posting an adjustment to Pacificorp's rate base for the average outstanding balance of Customer Deposits during the historic test year, I also post an adjustment for related interest expense to Pacificorp's proposed proforma or "normalized" above-the-line net operating income. By posting the related Customer Deposit interest expense as an above-the-line operating expense, the Company will remain whole for interest it must pay on such Customer Deposit funds.

Q. Why have you proposed to reflect the average test-year balance of Customer Deposits as a rate base offset, with corresponding interest as an above-the-line operating expense, rather than reflecting such low cost financing within the capital structure employed to develop an overall cost of capital?

A. Reflection of such low-cost Customer Deposits within the capital structure would only give ratepayers credit for a *portion* of the low-cost funds they provide vis-à-vis Customer Deposits. Specifically, since Pacificorp's capital structure supports utility as well as non-utility investments, reflecting utility Customer Deposits within the capital structure would have the effect of allocating a portion of the benefit of such low cost-funds to non-utility operations and/or non-ratebased utility investment. Or in other words, the low cost-financing benefits which only utility customers provide vis-à-vis Customer Deposits would be inequitably diluted to non-utility operations and/or to non-ratebased utility assets.

Additionally, if Customer Deposits were to be considered in the development of the overall cost of capital, it would be appropriate to include *all* Customer Deposits from all the states which Pacificorp serves – not just the Washington jurisdiction. Different states will no doubt have different Customer Deposit rules and interest requirements. By reflecting *Washington jurisdictional* Customer Deposits as an offset to the otherwise-calculated *Washington jurisdictional* rate base, Washington jurisdictional customers will be given exact and equitable credit for Customer Deposits they are collectively providing – nothing more or less. This same equitable result will not occur if Customer Deposits are included within the development of the overall cost of capital.

Q. Do you know why the Company has not reflected such low-cost funds anywhere in the ratemaking formula?

A. No. Both Public Counsel and the WUTC Staff questioned Pacificorp about the omission of Customer Deposits in the ratemaking formula. The Company's response stated:

> Neither interest expense on customer deposits nor the customer deposits liability is included in results of operation for ratemaking purposes. Since customer deposit interest is eliminated when interest on long term-debt is synchronized to net rate base, no rate base reduction is included for customer deposits.
> Response to Public Counsel Data Request No. 86.

This Company response is neither revealing or convincing as to why the Company apparently believes it is not necessary or equitable to consider the benefits of low-cost Customer Deposits in the ratemaking formula. The implication of the Company's response appears to be that it believes it has somehow equitably considered all interest-bearing financing when it synchronizes long-term debt interest to net rate base. However, it should be emphasized that the interest synchronization calculation referenced within the Company's response in effect charges ratepayers its proposed overall before-tax cost of capital (approximately 12.5%) on Customer Deposit funds that have an actual before-tax cost of only 1.18%. Accordingly, Customer Deposits should be used as a rate base offset with corresponding interest being reflected as an above-the-line operating expense as I am proposing herein. The Company's ill-founded explanation for completely ignoring the benefits of such low-cost financing in the ratemaking process should be rejected

Cash Working Capital

Q. Please briefly summarize Pacificorp's development of, and request for, a cash working capital allowance for rate base consideration.

A. Pacificorp proposes an addition to rate base in the amount of $7,246,671 for a cash working capital ("CWC") allowance. The Company's CWC allowance was developed by applying lag day calculation results from a 1998-vintaged Pacificorp lead lag study to test-year adjusted Washington operations. Specifically, the Company's CWC request was developed by employing an average revenue receipt day lag and an average expense day payment lag and applying such *net* revenue-receipt-day-lag in excess of expense-day-payment-lag to Washington jurisdictional average daily unadjusted test-year cash operating expenses.

Q. Please explain in more detail what you mean by the terms "lead-lag study," "revenue receipt" and "expense payment" lags."

A. A properly conducted detailed lead-lag study measures the number of days, on average, that a utility company must wait for receipt of revenues related to the provision of utility service. The time that a utility must wait for revenues related to the provision of utility service is referred to as the *revenue receipt lag.*

Further, a properly conducted lead-lag study measures the number of days, again on average, that a utility enjoys between the time that a *cash* expense is incurred in the provision of utility service and the time that such *cash* expense must be paid. For some *cash* expenses there is little or no time between when a good or service is provided and when the related expense payment is due. However, for many *cash* expenses the *expense payment lag* is significant – essentially allowing the utility to enjoy the use of another party's designated funds for extended periods of time.

If a utility – on average – must pay for *cash* expenses prior to receipt of related service revenues, the utility is deemed to have an ongoing investment in its *cash working capital requirement.* Conversely, if a utility – on average – enjoys a fairly lengthy period of time between incurrence of expense liabilities in the provision of utility service and the payment of such expense that actually exceeds the revenue receipt lag, the utility is deemed to have a *negative* cash working capital requirement. Under the latter scenario it is proper and equitable to deduct such *negative* CWC requirement from the otherwise-developed or calculated rate base. In other words, if the detailed lead-lag study supports such a conclusion, it is proper and acceptable to deduct the calculated negative cash working capital allowance from rate base in recognition of the fact that the Company has a continuous source of cost-free capital supporting its utility investments.

Q. In your previous answer you have emphasized that a properly conducted lead-lag study should consider *cash* expenses in its development. Can you expand upon the significance or the emphasis of considering *cash expenses* in a properly conducted lead-lag study?

A. A *cash* working capital allowance should consider the investment that a utility may have in continuously paying for *cash* expenses in advance of receipt of related service revenues. Utilities sometime argue that that they have an investment in *non-cash* expenses such as depreciation, amortization and deferred income taxes. Additionally, sometimes utilities argue that the common equity return portion of utility rates should be considered in the development of the cash working capital allowance or requirement. However, it is only expenses that require a *cash* outlay that potentially result in utility companies investing ongoing funds that should equitably be included in rate base. Further, jurisdictions that I have personally appeared in or before have correctly and equitably concluded that only expenses requiring a *cash* outlay are properly considered in a comprehensive lead-lag study.

Q. Are you in agreement with the Company-developed CWC allowance?

A. No. Detailed lead-lag studies are data and labor intensive undertakings. The lead-lag study which Pacificorp has relied upon is quite dated and ideally should be fully updated. Nonetheless, the calculations and development of most of the expense day lags appeared reasonable, and the results also appeared generally consistent with the results of other lead lag studies I have either undertaken or reviewed.

That stated, I believe the Company's study is significantly deficient in at least two key aspects. First, the revenue receipt lag, upon first impression – and later following some analysis – appears insupportably long. Second, the Company's lead-lag study completely fails to measure or consider the relatively long lag it enjoys in the payment of interest expense. The reflection of a more supportable revenue lag in conjunction with the consideration of the expense lag enjoyed by Pacificorp in the payment of interest expense has the impact of turning a fairly significant *positive* CWC allowance calculated and proposed by Pacificorp (i.e., the noted $7.25 million) into what I believe to be a much more reasonable *negative* CWC allowance (i.e., a rate base reduction or offset of approximately $3.7 million).

Q. Please expand upon your observation regarding the Company's proposed revenue receipt lag.

A. According to the Company's calculated revenue receipt day lag, Pacificorp must wait, on average, 47.9 days between the provision of utility service and receipt of related service revenues from its general business customers. This lengthy receipt lag appears unsupportable for two significant reasons.

Q. Please explain.

A. The total revenue receipt day lag is comprised of three separate subcomponents – a service period lag, a billing period lag and a collection period lag. The service period lag of 15.2 days calculated by Pacificorp is common to all lead-lag studies. The "service period lag" represents the average time from the mid-point of a service period to the end of the service period when the meter is read. More specifically, the service period lag is always one-half of the number of days in an "average" month – or the noted 15.2 days (i.e., 365 days in year divided by 12 months divided by 2 equals 15.2 days).

The "billing period lag" represents the period of time between when a meter is read (the end of a given "service period") and when such bill is processed and mailed. Finally, the "collection period" consists of the period of time that elapses from when a bill is either dated or received by the customer until when such bill is, on average, paid by utility ratepayers.

The Company's 1998 study calculates a retail billing period lag of approximately eleven (11) days. I do not know if the 1998 study properly or correctly calculated the eleven (11) day billing period lag. An eleven (11) day billing period lag is longer than any I can recall observing. That stated, even assuming the eleven (11) day lag was correct in 1998, it is significantly overstated today – if for no other reason – because of the Company's implementation of an automated handheld meter reading system. In discovery I inquired and learned about the Company's recently implemented handheld meter reading system. According to the Company's response to Public Counsel Data Request No. 127, with the 2003-installed handheld meter reading system, meters that are read on any given day are sent by mail very early in the morning of the second day following the meter read. Thus, at most the current billing lag is only two (2) days – not the approximate eleven (11) day period taken from the 1998 study that the Company has used in the development of its proposed cash working capital allowance.

Q. Please discuss and describe the second significant reason that you believe Pacificorp's 1998-developed revenue lag is unsupportable.

A. The documentation underlying the "Washington jurisdictional" revenue lag development is a bit sketchy. As noted, the Pacificorp-calculated revenue receipt day-lag for the Washington jurisdiction in total is 47.9 days. The billing lag, as just discussed, was calculated by Pacificorp to be approximately eleven (11) days. Thus, while I did not observe Washington-jurisdictional-specific calculations supporting its derivation of the "collection lag," it logically follows that the 1998 Pacificorp study is calculating a "collection day" lag of approximately 21.7 days (i.e., 47.9 total revenue receipt day lag less the 11 day billing lag equals a 21.7 day "collection" lag). In light of the current Washington jurisdictional tariff which addresses the number of days a customer has to pay for his/her utility service before incurring a late payment fee *and* the level of late payment charges billed during the test year, the approximate 22 day collection lag appears totally unsupportable.

Q. Please explain.

A. According to filed tariffs, Pacificorp bills must be received at Pacificorp's collection center or authorized pay stations within 15 days of "issuance." According to the Company's response to Public Counsel Data Request No. 150, the "issuance" date of a given Pacificorp bill is the date mailed. Thus the implication of a 22 day revenue collection lag is that, on average, Washington ratepayers are paying their utility bills seven (7) days beyond the due date.

If the "average" Washington ratepayer is paying his or her electric bill beyond the due date and incurring the tariff-authorized one percent (1.0 %) late payment charge, one would expect to observe very significant late payment charge revenues billed and recorded within the historic test year. However, according to the Company's response to Public Counsel Data Request No. 138 only $317,331 of late payment charges were billed during the historic test year. With late payment charges equaling one percent (1.0 %) of delinquent balances, the total "delinquent" test year balances upon which such late payment charges were assessed was approximately $31.7 million. However, it is easily observed that total Washington jurisdictional general business revenues during the historic test year were $198 million. Results of Operations Summary, page 2.2. Or in other words, the late payment charges actually assessed during the test year do not support a conclusion that "on average" Washington jurisdictional customers are paying their utility bills well beyond the due date posted on their bills. Accordingly, I submit that the Company's Washington jurisdictional collection lag is also significantly overstated.

Q. In light of your criticisms of the Company-proposed revenue receipt day lag, what are you proposing in the alternative?

A. I am proposing a total revenue receipt day lag of 34.2 days consisting of the following subcomponents:

Service lag	15.2
Billing lag	2.0
Collection lag	17.0
Total revenue lag	34.2

As previously stated, the service day lag should always calculate to be 15.2 days. Further, as a result of the newly implemented automated handheld meter reading system, the billing lag should now be only two days.

In light of the relatively low number of late payment charges assessed during the test year, I have estimated the collection lag to be 17 days. The 17 day estimate is two days beyond the delinquent date that triggers the one percent (1.0%) late payment charge. As such, I believe the estimate to be reasonable if not conservative. Even if the Company voluntarily "forgives" or foregoes the one percent (1.0%) late payment charge for payments received a day or two beyond the legal delinquent date, one would expect to see more late payment charges billed during the test year *if the actual collection lag is more than the 17 day estimate I have utilized.*

Q. Moving on to your second significant criticism of the Company's proposed cash working capital allowance, please expand upon the Company's failure to measure or consider the relatively long lag it enjoys in the payment of interest expense.

A. Very simply, Pacificorp's study fails to consider or quantify the lengthy lag it enjoys in the payment of interest expense. Most, although not all, of Pacificorp's debt supporting its utility investment has semi-annual interest payment requirements that are made at the end of the semi-annual accrual period. Further, interest expense makes up a significant portion of Pacificorp's total cost of service. Accordingly, proper reflection of the interest expense lag in the development of a lead-lag study has the impact of significantly changing the study results.

Q. Does the fact that interest expense is not generally considered or included as an "operating" expense have any relevance to the decision of whether to include or exclude the item in a lead-lag study?

A. Absolutely not. Interest expense is a part of the total cost of service that is being collected through utility customer rates. It is obviously as essential in the provision of electric utility service as payroll, fuel, property taxes or income taxes -- components that Pacificorp and other utilities routinely include in the development of a comprehensive lead-lag study. The fact that it is not classified as an "operating" expense has no relevance to the decision to include – or not include – such cash expense in a properly developed lead-lag study.

Q. How are you proposing to consider interest expense in the lead-lag study?

A. In response to Public Counsel Data Request No. 128 Pacificorp provided the interest accrual period and the interest payment date relative to each debt securities' interest accrual period. From this response I was able to calculate that, on average, interest expense is paid 85.2 days from the mid-point of the interest accrual period. Given that the revenue receipt day lag is only 34.2 days and that interest expense, with an expense payment lag of 85.2 days, is a considerable element of the Company's retail cost of service, it is easily observed that proper inclusion of the net payment lag associated with this cost of service component is significant to the lead-lag study results.

Q. Have you prepared a schedule which calculates the impact of your two noted changes to the Company-developed lead-lag study?

A. Yes. On attached Schedule B-2, I show test-year cash expenses by Company-developed lead-lag study categories as adjusted by Public Counsel. As shown on the noted schedule, by utilizing my proposed revenue receipt day lag of 34.2 days, and properly including the impact of interest expense in the study, I calculate a *negative* cash working capital allowance of $3,728,874. Accordingly, I am proposing that such *negative* cash working capital allowance be reflected as a reduction to the otherwise-calculated rate base.

Canal Embankment Failure at Swift No. 2 Hydroelectric Power Facility

Q. Please discuss your next adjustment to test year operating expense.

A. As shown on attached Schedule B-3, I am proposing to eliminate test-year expenditures related to repairs at the Company's Swift No. 1 hydroelectric facility that Pacificorp is seeking to recover from Public Utility District No. 1 of Cowlitz County. Because these expenditures are non-recurring, and further, may be reimbursed by Cowlitz County pursuant to litigation or settlement, it is inappropriate to include them in the development of Pacificorp's base rates.

Q. Please state your understanding of the failure, that occurred at Pacificorp's Swift No. 1 hydroelectric facility.

A. On April 21, 2002 a catastrophic failure of Cowlitz PUD's forebay dike occurred. Pacificorp reserved an easement in the canal and forebay owned by Cowlitz PUD for the purpose of passing water discharged from Swift No. 1 to Pacificorp's Yale Reservoir impoundment. As a result of the noted failure Pacificorp incurred both capital and operating expenditures during the historic test year. It is the incremental capital and operating expenses which Pacificorp incurred during the historic test year – which it now seeks to recover from Cowlitz PUD – that I am proposing to remove from Washington jurisdictional cost of service development. Response to Public Counsel Data Request No. 21.

Q. What action has Pacificorp taken to date in its effort to recover expenditures from Cowlitz PUD?

A. The Company served Cowlitz PUD with Tort Claim Notices under Washington law on April 7, 2004. The Company also previously sent letters to Cowlitz PUD summarizing its claim. To date, the Company has not filed any other legal pleadings seeking reimbursement from Cowlitz PUD. Responses to Public Counsel Data Request Nos. 21 and 133.

Q. What is the basis for your adjustment to test-year operating results?

A. In response to Public Counsel Data Request No. 21 the Company provided the test-year operating expenses and test-year capital expenditures that it also seeks to recover from the Cowlitz PUD. I have used the numbers provided in response to Public Counsel Data Request No. 21 in formulating my test-year expense and rate base adjustments.

Q. Assuming the Company is unsuccessful in recovering all of its damage claims incurred and presented to Cowlitz PUD, do you believe it is still equitable to reflect your proposed operating expense adjustment related to the Swift Canal failure?

A. Yes. Clearly if the Company is successful in achieving reimbursement from Cowlitz PUD, it would be inappropriate to again recover such costs from Washington ratepayers on a recurring annual basis until such time that a new rate application is filed employing a new test year. Thus, even if Pacificorp ultimately fails in its attempt to recover costs from Cowlitz PUD, it would still be inequitable to include such *non-recurring* expenses in the development of the adjusted test-year cost of service.

Miscellaneous Deferred Debits and Other Regulatory Assets

Q. Does Pacificorp's application seek rate recovery for costs that have been incurred in prior periods but which were "deferred" on its balance sheet rather than being immediately written off to expense in the prior period when incurred?

A. Yes. The Company's application seeks to recover a return on, as well as amortization of, costs incurred in prior periods that have been deferred for financial statement reporting purposes. Specifically, the Company's rate base proposal as shown on page 2.2 with the Results of Operations Summary includes $16,414,699 of Washington jurisdictional "Miscellaneous Deferred Debits" for which it is seeking a return. Additionally, the Company's filing incorporates Washington jurisdictional amortization expense in the amount of $4,862,257 associated with such Miscellaneous Deferred Debits.

Q. Do you concur with the Company's request for a return on, and return of, Miscellaneous Deferred Debits?

A. No. As shown on Schedule B-4, I am recommending that all costs for which Pacificorp has no current WUTC deferral authorization be eliminated from test-year cost of service development (both return of and on).

Q. Does Pacificorp have authorization from this Commission to defer any of the costs recorded as Miscellaneous Deferred Debits?

A. Pacificorp currently only has authority to recover Transition Costs which have been deferred pursuant to this Commission's order from Docket No. UE-000969.

Q. Does Pacificorp have any additional pending requests to this Commission to defer costs?

A. Yes. Pacificorp has sought authority to defer a number of environmental costs in Docket No. UE-031658. Additionally, Pacificorp seeks within WUTC Docket No. UE-031657 authority to defer Trail Mountain Mine closure costs.

Q. Why do you oppose Washington rate recovery of costs for which Pacificorp has no current WUTC authority to defer?

A. I believe deferral accounting for costs that would otherwise be immediately charged to expense should be limited to instances where:

- It has been demonstrated that the costs incurred are very significant to the utility's bottom line (if immediately written off).
- The utility is not already in an "over" or "excess" earning situation prior to incurring the costs sought for deferral accounting.
- The costs are non-recurring or infrequently incurred, and have not been included in some respect in the development of the utility's last cost of service.
- The costs have been demonstrated to be prudently incurred.
- The costs incurred and proposed to be deferred were undertaken for the benefit of the jurisdiction in which deferral accounting is being requested.
- Any and all "off-sets" or related savings have been netted against the costs incurred and for which deferral accounting is being sought.

- The utility has sought accounting authority from a given jurisdiction prior to, or at least shortly following, incurrence of the costs which it seeks to defer.

In short and in sum, deferral accounting should only be authorized if the costs are significant, prudently incurred, beneficial to ratepayers, and if the utility makes a compelling application prior to or immediately following the incurrence of such costs. Deferral accounting should be the *exception* rather than the *rule*.

Q. Do any of the Miscellaneous Deferred Debit costs which you are eliminating from Pacificorp's proposed Washington retail jurisdictional cost of service meet these criteria?

A. Turning first to the category of costs for which Pacificorp has neither current WUTC deferral authority nor any pending application to this Commission to defer, I submit the answer is a definite "no" – the company does not meet these criteria. For these costs the Company has made no demonstration that such costs are significant to its bottom line, are benefiting Washington retail ratepayers, are *not* being recovered in current base rates, or that there are no offsetting savings or benefits. Further, several of these costs which the Company elected to defer on its books without regulatory authority were incurred many years ago without a demonstration as to need, benefit or prudence. Accordingly, the return of (i.e., amortization) and return on (i.e., rate base) these items should be excluded from Washington jurisdictional cost of service development. See Schedule B-4.

Q. What of the costs for which Pacificorp has applied for WUTC accounting authority, but for which this Commission has not issued an authorizing order?

A. First I would note that many of the deferred costs were incurred many years ago. Accordingly, the Company has not met at least one of the criteria that I believe should be achieved before accounting authority is granted – namely, the criteria that accounting authority should be sought before, or shortly following, the incurrence of such costs.

Second, the description of items given by Pacificorp in response to Public Counsel Data Request No. 71 are so brief in most instances so as to be unrevealing as to their nature or benefiting jurisdictions. Accordingly, thus far Pacificorp has not even approached meeting its burden of proof for prospective cost recovery of items incurred many years prior. Along these same lines, the brief descriptions provided indicate that the deferred costs were often incurred in jurisdictions other than Washington. I am aware that the allocation/assignment of production costs is a significant issue in this proceeding. For instance, Public Counsel is recommending that hydro production costs be assigned on a situs basis (and thermal costs be assigned on a control area basis). This Commission's decision on production cost assignment/allocation may automatically have the effect or impact of eliminating such Company-requested deferred cost recovery from Washington retail jurisdictional cost of service development. That said, even if this Commission should ultimately reject Public Counsel's production cost assignment recommendation and elect to include some allocated portion of other states' production facilities, I would still submit that the Company should have the burden of proof regarding the quantification, need, or benefit to Washington retail ratepayers of costs incurred and initially deferred in other Pacificorp jurisdictions.

IRS Settlement Payments

Q. Please briefly summarize Pacificorp's request to recover over a five year period payments made to the Internal Revenue Service.

A. Pacificorp proposes to recover over a period not-to-exceed five years payments made to the Internal Revenue Service ("IRS") during the test year and through the period ending March 31, 2004. Pacificorp witness, Mr. Larry Martin, explains that such payments relate to tax years 1991 through 1998 that have only recently been audited, litigated and/or settled. Direct Testimony of Larry O. Martin, page 4. Pacificorp proposes that the IRS payments be allocated to the Washington jurisdiction based upon Washington's-Income-Before-Tax as a percentage of total-Pacificorp-Income-Before-Tax over the same 1991 through 1998 time period. Response to WUTC Staff Data Request No. 124.

Q. Are you in agreement with Pacificorp's proposal to amortize the cost of recent payments to the IRS over a five year period?

A. No. I believe Pacificorp's proposal should be rejected for a number of reasons. Accordingly, as shown on Schedule C-1, I am proposing to reverse or eliminate this Company-proposed adjustment to test-year income tax expense.

Q. Please explain.

A. My rejection of the Company's proposed adjustment can be broken down to three major concerns:

- It is unknown how much of the settlement payment relates to Washington retail operations.
- It appears that the vast majority of the settlement payment relates to book/tax timing difference that have been "normalized" for ratemaking purposes. For settlement payments related to timing differences that have been afforded normalization treatment in Washington regulatory proceedings, such payments should be charged against Accumulated Deferred Income Taxes – a balance sheet account – rather than current year operating income.
- It is unknown whether Washington jurisdictional earnings, calculated utilizing a WUTC-authorized jurisdictional allocation methodology, were so low as to be unable to absorb such extra tax expense without a rate change in any given previous year for which a dispute has now been resolved.

Accordingly, I propose that Pacificorp's proposal to amortize the noted IRS settlement payments over a five year period be rejected in its entirety.

Q. Referring to your first argument in opposition to the Company's proposed tax adjustment, please expand upon your claim that it is unknown how much of the settlement payment relates to Washington jurisdictional operations.

A. I have reviewed Pacificorp's response to WUTC Staff Data Request No. 124 which provided a summary of items in dispute with the IRS by year over the entire period

1991 through 1998. It is clear from such review that many disputed items for which payments were recently made relate to components that would have little or nothing to do with Washington retail operations.

It should be remembered that Pacificorp has proposed the very simplistic methodology of allocating the settlement tax payments to Washington based upon Washington's Income-Before-Tax as a percentage of total Pacificorp Income-Before-Tax over the 1991 through 1998 time period. Thus, the more profitable the Washington jurisdiction was during the 1991 through 1998 time period, relative to Pacificorp in total, the more of the tax payment Washington is being asked to bear. If Washington were to be responsible for any portion of the recent payments to the IRS, it should only be responsible for the portion that would have been allocated or assigned to the Washington jurisdiction during the period that the tax would have been paid had it been originally known that the liability would ultimately or eventually be due when the tax return was first filed. Thus, Pacificorp has failed to equitably allocate the recent tax payments to its various operating divisions.

Q. Turning to your second argument, please explain what you mean by your reference to "settlement payments related to timing differences that have been afforded normalization treatment in Washington regulatory proceedings….. should be charged against accumulated deferred income taxes…rather than current year operating income?"

A. There are many instances wherein there is a difference between the time a dollar of revenue or dollar of expense is recognized for financial statement reporting purposes *versus* the time such item is recognized as income for purposes of developing federal or state taxable income. Whenever an item is recognized as an expense or deduction for federal/state income tax development purposes over a different period, or in a different amount, than what is recognized for financial statement reporting and utility cost of service rate development purposes, it is most commonly referred to as a "book/tax timing[3] difference." Historically, most book/tax timing differences were expensed or deducted for purposes of developing federal/state taxable income faster and/or sooner than they were recognized for financial statement reporting and utility cost of service rate determination purposes.

Q. Please explain what is meant by "normalization" tax accounting.

A. Under "normalization" accounting, income tax expense for cost of service development and financial statement reporting purposes (sometimes also referred to as "book" income) is calculated as if "book" income equaled "taxable" income. The difference between total income tax expense calculated based upon "book" income and actual taxes paid pursuant to "taxable" income reported on the entity's tax return (i.e., current income tax expense) is commonly referred to, and actually appears on public financial statements, as "deferred" income tax expense.

[3] While the majority of book/tax differences are *timing* differences, there also exists a relatively small number of *permanent* book/tax differences.

Mechanically, deferred income taxes are typically established for each book/tax timing difference by multiplying the then-current federal and state income tax rate times each given book/tax timing difference. Such method essentially anticipates that income tax rates in effect in any given tax year will be in effect in the future when the book/tax timing difference "turns around." Under normalization accounting, total tax expense calculated on "book" income is recognized for financial statement reporting purposes even though a portion of the ultimate payment is "deferred" to a period when each contributing timing difference turns around. The "deferred" tax expenses are accumulated on the Company's balance sheet – essentially representing a long term income taxes payable account – and most often referred to as "Accumulated Deferred Income Taxes." When the book/tax timing difference "turns around" such that an item previously "deducted" for purposes of calculating taxable income is later "expensed" for financial statement reporting purposes, a "negative" or "credit" deferred tax expense is recognized. When the actual payment to the income taxing authority stemming from the turnaround of a given book/tax timing difference is made, such payment is charged against the "Accumulated Deferred Income Tax" reserve account established at the time the book/tax timing difference first arose.

Q. What is the alternative to "normalization" accounting?

A. "Flow through" accounting. Under "flow through" income tax accounting, financial statement reporting and cost of service income tax expense is developed by considering *actual taxes paid* to income taxing authorities. Thus when tax *deductions* exceed book *expenses*, ratepayers typically benefit under flow through accounting, at least in the short run, as income taxes actually paid and recorded as expense will be less than income tax expense recorded (and used for cost of service development) under "normalization" accounting. However, all other things held constant – including Federal and State income tax rates over time – ratepayers will ultimately pay the same amount of income tax expense through utility rates whether "normalization" or "flow through" accounting is employed. It is primarily the *timing* of the collection of the payment of income taxes from ratepayers that will vary depending upon whether flow through or normalization accounting is employed.

Q. Does the WUTC follow "flow through" or "normalization" accounting when developing retail rates?

A. Pursuant to the Internal Revenue Code (hereinafter "IRC" or "Code"), differences in depreciation lives (i.e., book versus tax) and methods (generally tax accelerated versus book straight line) must follow "normalization" accounting for rate making purposes in order for the utility to retain the ability to adopt accelerated tax depreciation elections (hereinafter I will occasionally refer to these differences as "Code protected differences"). From the Company's response to Public Counsel Data Request No. 18 it would appear that beyond normalizing Code protected depreciation differences, this Commission has only occasionally adopted normalization accounting. Or in other words, except for Code protected differences, this Commission has *generally* followed flow through accounting.

Q. Is the past treatment afforded book/tax timing differences an important distinction when evaluating the Company's request to collect through Washington utility rates an amortization of IRS settlement payments that relate to tax years 1991 through 1998?

A. Yes. Specifically, to the extent the IRS settlement payment stems from an election taken by the Company related to a book/tax *timing* difference, *and* such book/tax timing difference was afforded normalization tax accounting treatment for ratemaking purposes, ratepayers would have already paid through utility rates the tax that Pacificorp has only recently tendered to the IRS.

Q. Please expand upon how utility ratepayers have already paid through utility rates income taxes that Pacificorp has only recently paid the IRS.

A. Recall my earlier explanation wherein I described how under normalization tax accounting, utility rates are sometimes designed based upon a cost of service tax calculation that effectively only considers "financial statement reporting" expenses. To the extent the utility tax payer makes an election to take an accelerated tax deduction that exceeds "book" or "regulatory" expense,[4] the resulting reduction in taxable income is not considered in the development of cost of service income tax expense. Rather, under tax normalization accounting and ratemaking, the difference between income taxes actually paid to taxing authorities and income tax expense calculated by only considering revenues and expenses recognized for regulatory and

[4] Book/tax timing differences can result from revenue as well as expense differences. Further, in some instances recognition of a "book" expense may actually precede the ability to take a tax "deduction." However, since the majority of book/tax differences arise from differences in which a tax "deduction" precedes or initially exceeds a "book" expense, my discussion will be limited to the most frequently situation.

financial statement reporting purposes is "deferred." Thus, the difference between taxes actually paid and the *total* tax expense recorded is deferred and accumulated on the utility taxpayer's balance sheet in a long term taxes payable account (i.e., Accumulated Deferred Income Tax Reserve). When in the ensuing years the accelerated tax deduction immediately or eventually becomes smaller than the corresponding book expense – thus driving taxable income and the resulting tax payment due to the taxing authorities higher – a "negative" deferred income tax expense is recorded. At the point of the "turnaround" just described, income taxes payable to the taxing authorities which exceed tax expense being reported for financial reporting and ratemaking purposes will effectively be paid out of the "Accumulated Deferred Income Tax" reserve established when the book/tax timing difference first originated.

The important point to be gleaned from the explanation above is that, to the extent portions of the IRS settlement payment for tax years 1991 through 1998 relate to book/tax timing differences that were afforded explicit or *implicit* tax normalization treatment when setting Washington retail rates, ratepayers have already paid through utility rates the tax lability that Pacificorp has only recently tendered to the IRS. To be more specific, to the extent the IRS payment relates to a timing difference that has been previously normalized, the tax payment should be charged against an accumulated Deferred Income Tax reserve account (i.e., against a balance sheet account) *rather than* a charge to current year income – for possible recovery in future rates as Pacificorp is now proposing.

Q. Did the recent payments to the IRS relate to book/tax timing differences that were previously normalized?

A. The Company's response to WUTC Staff Data Request No. 124 shows that the vast majority of book/tax differences were *timing* differences. Further, the Company's response to Public Counsel Data Request No. 18 (f) reveals that none of the items in dispute were afforded "flow through" treatment – or in other words, all book/tax timing differences in dispute were afforded tax normalization treatment in the prior 1986 Washington rate case. Thus, virtually all of the settlement payment appears to be related to timing differences that were previously afforded "tax normalization" treatment in Washington. More specifically, to the extent some of the timing differences contributing to the settlement payment relate to *Washington* operations, such timing differences have been normalized. Accordingly, the IRS payment causing current income tax expense to increase related to those items previously normalized should have an offsetting "negative" or "credit" deferred income tax expense.

Q. Finally, still on the topic of the Company's proposed amortization of the recent IRS settlement payments, please expand upon your final argument that it is unknown whether Washington jurisdictional earnings, calculated utilizing a WUTC authorized jurisdictional allocation methodology, were so low as to be unable to absorb such extra tax expense without a rate change in any given previous year.

A. Assuming *arguendo* that some significant portion of the settlement payment related to Washington retail operations *and* that the difference stemmed from a *permanent* rather than timing difference that had been afforded tax normalization treatment, it still would not necessarily follow that Washington retail ratepayers should pay an added tax bill at this point in time. Specifically, if Washington retail operations were earning at, near or above expected returns during the time period that the tax liability was actually being incurred, such that no rate change would have been required even considering some additional tax expense, it would not be appropriate to now charge Washington ratepayers an expense that would have easily been absorbed in the prior period when the liability was actually occurring.

Q. Please summarize your opposition to the Company's adjustment proposing to amortize recent payments to the IRS over a five year period.

A. It is clear that Pacificorp has not attempted to equitably assign or allocate the payments to the divisions or jurisdictions where the dispute arose – and who might now be responsible. Further, assuming some of the book/tax *timing* differences which were the source of the IRS dispute and the ultimate payment relate to Washington jurisdictional operations, at *most* Washington jurisdictional customers should only pay the tax bill related to either *permanent* book/tax differences or book/tax *timing* differences that were afforded "flow through" rate making treatment. According to a Company response to Public Counsel data requests, all timing difference in dispute were afforded "normalization" rate making treatment. As discussed in detail above, to the extent "normalization" accounting was followed for the items in dispute, ratepayers would have already paid through utility rates the tax liability that the Company settled with its recent payments to the IRS.

Finally, the Company has made no attempt to determine whether rates in prior periods – when the tax liabilities were actually accruing – would have been adequate to absorb such extra costs without a change in rate. For all reasons noted, I do not believe the Company has even approached meeting its burden of proof on this issue. Accordingly, the Company's proposed adjustment should be rejected in its entirety.

Employee Benefits Other Than Pension and Post-Retirement Medical

Q. The Company has proposed an adjustment to test year operating expense in the amount of $2,265,656 for expected increases in employee pensions and benefits expense. Are you in agreement with this Company proposed adjustment?

A. The noted Company adjustment consists of three elements: pension costs, post-retirement medical/other benefits ("PRMB") costs, and an "all other category" consisting of a number of non-retirement benefits such as current medical, dental, disability, and life insurance – just to name a few. Response to Public Counsel Data Request No. 134. I am not opposing the Company's adjustments for pension and PRMB expense. However, I am recommending that the Company's adjustment for the "all other" employee benefits category be rejected. On Schedule G-2 I therefore reverse that elements of Pacificorp's proforma employee benefits adjustment that related to the "all other" category.

Q. Please explain.

A. In support for its adjustment to increase pensions and PRMB expense, Pacificorp has offered current actuarial studies which underlie the level of expense which it proposes to recover in rates – and the level of expense which it began recording as operating expense during the fiscal year which began on April 1, 2003. I believe one could credibly argue that the higher level of pension and PRMB costs being proposed for rate recovery by Pacificorp represent "out of test year" expenses that should be rejected because they create "matching" problems. However, I am not opposing these elements of the Company's benefits adjustment inasmuch as I understand that the WUTC routinely accepts these types of "known and measurable" adjustments – even though they occur immediately following the end of the historic test year.

With regard to the "all other" category of non-retirement expenses, the Company's support is far less solid. Specifically, the Company has simply proposed to reflect a fiscal year 2004 budget amount for this item, with the result being a 13.5% increase in test year actual expense for the "all other" category of employee benefits expense.

Q. Is the fiscal year 2004 budget amount that the Company proposes to use to adjust test year actual operations for employee non-retirement benefits "known and measurable?"

A. With regard to pension and PRMB costs the Company offers an actuarial study which supports the proforma rate case level of expense being proposed – which is also the level that Company recorded as operating expense during fiscal year 2004. For the category of “all other” non-retirement benefits the Company has merely proposed a Fiscal-Year-2004 budget amount. And while the budget for this line item may have been prepared utilizing reasonable assumptions, they obviously do not carry the ‘known and measurable” precision of actuarial studies that support the pension and PRMB expense levels being proposed and which were ultimately recorded during fiscal year 2004.

Q. Did Pacificorp experience the 13.5% increase in non-retirement benefits costs in fiscal year 2004 that had been predicted in its fiscal year 2004 budget?

A. No, Pacificorp incurred only a 2.0% increase in non-retirement benefit expense during fiscal year 2004 (Calculated from response to Public Counsel Data Request No. 10). Thus, the Pacificorp-predicted 13.5% increase – even if reasonable when first estimated or calculated – certainly never elevated to the criteria of being “known and measurable.” Accordingly, the non-retirement elements of Pacificorp’s pension and benefits expense adjustment should be rejected.

Interest Synchronization for Purposes of Calculating Cost of Service Income Tax Expense

Q. Please explain your last adjustment to test year adjusting operating income.

A. The adjustment shown on Schedule C-3 merely synchronizes the interest deduction to be used in the development of cost of service income tax expense with the rate base that I have calculated and the cost of capital recommendations being made by Public Counsel's cost of capital witness Mr. Stephen Hill. This standard adjustment is required in order that ratepayers are properly credited with an interest expense deduction in the cost of service income tax calculation that is synchronized with the rate base and cost of capital being recommended. The Commission's order should reflect a revised interest synchronization adjustment that is based upon the Commission's findings regarding all rate base and cost of capital issues.

Q. Does this conclude your direct testimony?

A. Yes, it does.