Exhibit T___ (TES-1T)
Docket No. UE-032065
Witness: Thomas E. Schooley

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMISSION, Complainant, v. PACIFICORP, d/b/a PACIFIC POWER & LIGHT COMPANY Respondent.	DOCKET NO. UE-032065

DIRECT TESTIMONY OF

THOMAS E. SCHOOLEY

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

July 2, 2004

Q. Please state your name and address.

A. My name is Thomas E. Schooley. My business address is 1300 S. Evergreen Park Drive S.W., PO Box 47250, Olympia WA 98504-7250.

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

A. I am employed by the Washington Utilities and Transportation Commission as a Regulatory Analyst in the Regulatory Services Division.

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

A. Since September 1991.

I. QUALIFICATIONS

Q. Please briefly describe your educational background and experience at the Commission.

A. I received a Bachelor of Science degree from Central Washington University in 1986. I met the requirements for a double major in Accounting and Business Administration-Finance. Additionally, I have a Bachelor of Science degree in geology from the University of Michigan. I passed the Certified Public

Accountant exam in May 1989. Since joining the Commission, I have attended several regulatory accounting courses, including the summer session of the Institute of Public Utilities.

I testified in Docket No. UE-960195 involving the merger between Washington Natural Gas and Puget Sound Power & Light. I was the lead Staff analyst in several applications for accounting treatment, including Puget Sound Energy, Inc. Docket Nos. UE-971619 and UE-991918. I testified in the Avista general rate case, Docket No. UE-991606, and Avista's energy recovery mechanism, Docket Nos. UE-000972, UE-010395, UE-011595, and UE-030751. I also assisted in the development of Staff testimony in PRAM 2, Docket No. UE-920630, concerning Puget, and I presented the Staff recommendation on environmental remediation in Docket No. UE-911476 concerning Puget. I analyzed PacifiCorp's proposed accounting treatment of Clean Air Act allowances in Docket No.UE-940947, and participated in meetings of PacifiCorp's inter-jurisdictional task force on allocations. Most recently I testified in Puget's power cost only rate case, Docket No. UE-031725.

I have prepared detailed statistical studies for use by Commissioners and other Commission employees, and have interpreted utility company reports to determine compliance with Commission regulations.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your direct testimony?

A. I present the Staff's summary results of operations and recommended Washington revenue requirement for PacifiCorp in this general rate case. Staff's recommendation is based on a transitional control area assignment and allocation method that differs from the Company's Washington Protocol method.

Q. Do you sponsor any exhibits in support of your testimony?

A. Yes. I sponsor the following exhibits:

Exhibit ___ (TES-2), Staff's Results of Operations and Revenue Requirement

Exhibit ___ (TES-3), Results of Operations Comparison

Exhibit ___ (TES-4), Investor-supplied Working Capital,

Exhibit ___ (TES-5), Environmental Remediation, Adjustment 8.1

Q. Please provide a brief summary of Staff's revenue requirement recommendation.

A. Based on the analysis and accounting adjustments of Staff witnesses in this proceeding, Staff recommends a revenue requirement increase for PacifiCorp's Washington operations of $5,931,751, which is equivalent to an average rate increase of about 2.9%. This compares to PacifiCorp's requested increase of $26,724,248 or 13.5%. Staff's recommendation is based on an overall rate of return of 7.716% applied to a rate base of $505,194,796.

Q. What ratemaking adjustments do you cover in your testimony?

A. I present Staff's position on the following Company adjustments:

Pensions, Post-retirement Benefits, and Employee Benefits (Adj. 4.2)
Property Insurance (Adj. 4.11)
Trail Mountain Closure (Adj. 5.3)
Environmental Remediation (Adj. 8.1)
Jim Bridger Mine (Adj. 8.3)
Working Capital (Adj. 8.11).

I also testify regarding the following Staff proposed adjustments:

Remove RTO West Expenses (Adj. 5.9)
Skoocumchuck Dam (Adj. 8.12)
Customer Deposits (Adj. 8.13)
Miscellaneous Deferred Debits (Adj. 8.14).

Q. Which adjustments are uncontested by Staff, except for the issues of allocation factors or control area assignment?

A. Staff is not contesting the following adjustments:

USBR/UKRB Discount (Adj. 3.4)
SO_2 Emission Allowances (Adj. 3.5)
Special Revenue Reclassification (Adj. 3.7)
FAS 106 (Adj. 4.1)
Blue Sky Program (Adj. 4.3)

Wages (Adjs. 4.5, 4.6, 4.7, 4.8)
FERC Price Cap Accrual (Adj. 4.10)
Sale of Naches Hydro (Adjs. 4.12 and 8.6)
Severance Accrual (Adj. 4.13)
Removal of Colstrip (Adj. 5.2)
FAS 133 (Adj. 5.4)
West Valley Lease (Adj. 5.5)
Load Curtailment Reversal (Adj. 5.6)
Depreciation Expense (Adj. 6.1)
Accumulated Depreciation (Adj. 6.2)
ProForma Depreciation (Adj. 6.3)
Proforma Accumulated Depreciation (Adj. 6.4)
Colstrip 4 AFUDC (Adj. 8.4)
Dave Johnston Mine Closure (Adj. 8.5)
MSP Fuel Adjustment (Adj. 5.8)
Hydro Relicensing (Adj. 8.9)
System Benefit Charge (Adj. 8.10)

Staff reserves the right to bring any of these topics to the Commission's attention in future proceedings.

III. RESULTS OF OPERATIONS AND REVENUE REQUIREMENT

Q. Please describe Exhibit ____ (TES-2), showing Staff's results of operations and proposed revenue requirements.

A. The basis of Staff's revenue requirement recommendation is the Company's presentation of its results of operations, but based on a control area allocation method. This model was provided in PacifiCorp's response to Staff Data Request

213. Mr. Buckley describes the resource assignments using the control area method in his testimony. From an accounting viewpoint, one major change is the assignment of Washington's state-imposed taxes to Washington, and the exclusion of other states' taxes from Washington's results.

Exhibit ____ (TES-2) sets forth Staff's adjustments to the starting point of the Company's control area run in more detail.

Q. Please describe your comparison of the results of operations in Exhibit ___ (TES-3).

A. Exhibit ____ (TES-3) compares PacifiCorp's adjustments as presented in its filed case with Staff's filed case. The first page compares PacifiCorp's Washington Protocol-based results of operation with PacifiCorp's recasted results based on a control area allocation method (including PacifiCorp's proposed adjustments). The second page compares PacifiCorp's control area recast to Staff's filed case. Both comparisons are presented on a net operating income basis. (Net operating income is called "operating revenue for return" in PacifiCorp's documents.)

Q. Please compare PacifiCorp's recast of its results of operations using the control area allocation method proposed by Staff with the results PacifiCorp presented using its Washington Protocol.

A. PacifiCorp shows a net operating income of $36,349,000 and a total rate base of $596,314,000 based on its proposed Washington Protocol allocation method. This results in a 6.1% return on rate base. Mr. Buckley addresses the issues and concerns of Staff with the Washington Protocol allocation method in his testimony.

The control area-based cost allocation method proposed by Staff for this case results in a net operating income for PacifiCorp's Washington operations of $24,786,000 and a total rate base of $548,513,000. The result is a 4.5% return on rate base. These are Staff's starting points as shown in Ex. _____(TES-3), page 1, columns c and f.[1]

I will now address the contested adjustments for which I am responsible.

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[1] In Ex ___ (TES-3) columns h and k on page 2, respectively, equal columns c and f of page 1.

Pension & Benefit Adjustment, Adjustment 4.2

Q. Please present your adjustment to pensions and benefits.

A. Adjustment 4.2, is composed of three parts: pensions, post-retirement benefits other than pensions (PBOP), and employee benefits. The pension portion and the post-retirement benefits portions are actuarially determined using data from the period ending January 1, 2003. The employee benefits portion is based on the Company budget for the fiscal year (FY) ending March 2004.

Q. Please describe the pension and PBOP portions of this adjustment.

A. The financial expense for pensions and post-retirement benefits other than pensions is calculated to represent the value of the future benefits as the employees earn those benefits today. The methods for calculating this expense are determined by the accounting standards SFAS 87 and 106. Both standards use many assumptions and estimates.

Q. Is there a related docket concerning an accounting petition for pension expenses?

A. Yes, in Docket No. UE-031878, PacifiCorp requests: 1) authorization of accounting treatment relating to pension liability; and 2) confirmation by the

Commission that certain actuarially determined pension costs are recoverable in rates.

Q. Must the Commission resolve this accounting petition in the present general rate case?

A. No, PacifiCorp requests a Commission ruling on the accounting petition after this rate case. The Company recognizes that the Commission's decision in this docket may have a bearing on the outcome of the accounting petition. Staff will address the specifics of the accounting petition in that future proceeding.

Q. What is Staff's proposal in the current docket?

A. Staff accepts the Company's calculation of the expense level for pension cost and other post retirement benefits. However, the Company's adjustment double counts pension-related costs between the pension expense itself and the recovery of transition costs allowed in the Scottish Power merger. Thus, Staff removed $1,502,000 from the pension adjustment. This Washington assigned amount represents the level of pension cost that is related to the early retirement program and recovered through the amortization of merger transition plan costs. By accepting the actuarially determined level of pension expense in this instance, Staff does not forgo any other potential positions concerning PacifiCorp's accounting petition in Docket No. UE-031878.

Q. Please describe the employee benefits portion of Adjustment 4.2.

A. The employee benefit expense is based on the current expenses incurred by the employees of the Company. This portion of the adjustment compares the actual expense of FY 2003 with the Company's budget for FY 2004. That 2004 budget amount was over $69.4 million, but the actual figure for the fiscal year ending in March 2004 was $62.4 million. The $62.4 million figure is in line with the expense pattern of the recent past. Staff, therefore, used the actual FY04 expense for employee benefits in its adjustment. This reduces Washington's portion of the expense by $537,000.

Q. What is Staff's total revision to Company Adjustment 4.2, Pension & Benefits?

A. Taken together, Staff's adjustment reduces the Washington allocated portion of the adjustment to $24,399 compared to the Company's adjustment of $2,265,656.

Property Insurance, Adjustment 4.11

Q. What is your adjustment to property insurance?

A. PacifiCorp includes a contingency for estimated property losses in the future. The use of a contingent expense, as proposed by the Company, in essence, turns the customers into an insurer. Thus, Staff has consistently rejected such contingencies, instead relying on an average of recent incurred losses. It is fair to include an expense for property losses in the results of operations. While a given year of losses may not be typical, a recent average is reasonable for ratemaking purposes. Application of that method resulted in Staff's adjustment to reduce Washington's property and insurance expense by $953,000.

Q. How are the property losses allocated in the Company's adjustment 4.11?

A. PacifiCorp allocates all property losses and insurance with the "system overhead" (SO) factor.

Q. What are Staff's concerns with the Company's method?

A. Staff accepts that insurance premiums for unspecified plant failures may need to be allocated across all the plant and, therefore, across both control areas. But, if insurance is purchased for specific plants, the premiums should follow each plant. Uninsured losses to generation and transmission plant should remain within each control area. Distribution plant losses should be situs assigned. This flows from the principle that, to the greatest extent possible, each state should be responsible for the costs it imposes on the total system. Staff's adjustment is based on the SO factor, but we maintain that an improved cost assignment system is possible and would more fairly distribute costs across PacifiCorp's system.

Trail Mountain Closure Amortization-Adjustment 5.3

Q. Please discuss this adjustment.

A. In its adjustment, the Company includes in the Washington results of operations PacifiCorp's share of the amortization expense related to the closure of the Trail Mountain mine. The adjustment also excludes from revenues the joint owners' payment of their portions of the amortization expense, and reflects in rate base the unamortized balance as a regulatory asset. The background and details of this adjustment are discussed by Company witness Mr. Weston. (*See* Exhibit No. ___ (JTW-1T), at 14-16).

Staff does not accept the Company's proposal because the Trail Mountain costs are directly related to Eastern Control Area power supply. The exclusion of these costs from Washington results of operations is consistent with the control area based cost allocation method proposed by Staff.

Therefore, Staff's Adjustment 5.3 removes the joint owners' payment of their share of amortization expense, excludes the proposed amortization expense, and removes the booked unamortized balance of the Trail Mountain closure costs and un-recovered investment.

Staff's adjustment decreases Washington net operating income by $21,969 and decreases Washington rate base by $2,522,908.

Remove RTO West Expenses-Adjustment 5.9

Q. Please discuss this adjustment to remove RTO West expenses.

A. This adjustment excludes from the Washington results of operations expenditures incurred during the test year that are related to the formation of RTO West (now known as Grid West). Staff witness Mr. Buckley discusses the reasons for this adjustment in his testimony. The Washington allocated portion of RTO West-related legal and consulting fees of $166,419 and internal employee direct and incidental costs of $113,426 comprise Staff's adjustment to the operating expenses.

The reduction in operating expenses increases Washington net operating income by $181,899.

Environmental Settlement-Adjustment 8.1

Q. Please explain your adjustment for environmental settlement.

A. This is a two-part adjustment by Staff. The first part pertains to the Company proposal to reduce Washington rate base by the fund balance from insurance settlements for environmental clean-up projects as explained by Company witness Mr. Weston. (*See* Exhibit ___ (JTW-1T) at 22.)

Q. Does Staff accept this proposal by the Company?

A. Yes. This portion of the adjustment reduces Washington rate base by $1,685,506.

Q. What is involved in the second part of the adjustment?

A. The Company shows in its per books the amount of $9,582,000 for environmental remediation projects throughout its system. Approximately $727,000 of this total is allocated to Washington rate base by PacifiCorp and it is part of the Misc. Deferred Debits shown on line 35, page 1.0 of Exhibit ___ (JTW-3).

Q. Please provide a brief background of this issue.

A. On October 13, 2003, the Company filed in Docket No. UE-031658 an accounting petition seeking authority to record and defer costs incurred in connection with its environmental remediation program on an ongoing basis. The petition also requests authority to record these costs in FERC account 182.3 and to amortize the balance over ten years. The Company claims that the requested accounting treatment is consistent with previous ratemaking determinations in other states where it has utility operations and that it seeks consideration of these costs in this general rate proceeding. Apparently "seeking consideration" means including the unamortized balance in the per books portion of Miscellaneous Deferred Debits, without any explanation in testimony or otherwise.

Q. What is the Staff recommendation with respect to the $727,000 of deferred environmental costs included by the Company in Washington rate base?

A. The Commission has authorized deferral and amortization of environmental remediation costs incurred by other utilities in the past, provided that the expenditures were not found to be imprudent. Staff does not wish to impede the utilities from incurring legitimate costs to clean up the environment. However, Staff recommends that only those costs incurred for actual on-site clean up of environmental sites in PacifiCorp's Western Control Area be allocated to Washington. This is consistent with the Staff transitional inter-jurisdictional allocation methodology. Thus, Staff removed certain costs that are properly assigned to sites in the Eastern Control Area, included other costs that are properly assigned to sites in the Western Control Area, and used the system overhead allocation factor to allocate remaining costs to Washington. Staff also excluded legal expenses and PacifiCorp staff time from the deferred balances. Staff's calculation of deferred environmental remediation expenditures is $466,487. This represents a decrease of $260,308 in Washington rate base from the unadjusted Washington allocation of $726,796.

Q. Why did Staff exclude legal fees and PacifiCorp internal staff time from the deferred balance?

A. In prior orders concerning deferred environmental remediation expenses, Staff has expressed concern that by deferring legal expenses the utility may have an incentive to excessively litigate the utility's role in the clean-up process. The Commission has agreed to the exclusion of legal expenses in accounting petitions concerning Puget. Docket No. UE-911476. The emphasis of the deferred accounting should be on cleaning up the affected sites. Staff's exclusion of the PacifiCorp internal labor is consistent with prior Commission orders.

Jim Bridger Mine Rate Base, Adj. 8.3

Q. What is your adjustment to the Jim Bridger Mine?

A. PacifiCorp's Adjustment 8.3 brings the capital cost of the mine into rate base because the mine is recorded as a subsidiary on PacifiCorp's books. Staff accepts this in concept, but contests the inclusion of working capital-related items in the rate base determination. The Jim Bridger Mine and associated plant are Western Control Area resources. For Adjustment 8.3, Staff removed the working capital items for Materials & Supplies, Accounts Receivable, Pit Inventory, Prepayments, and Accounts Payable. The system-wide sum of these items is $13,886,873, leaving the net plant at $39,291,668. Washington's control area allocation is $8,892,883.[2]

A further explanation about working capital is provided next in my testimony concerning Adjustment 8.11.

[2] Adjustment 8.2 for the Trapper Mine is similar to Adjustment 8.3. This plant serves the Craig Plant, which is assigned to the Eastern Control Area. If it were included in Washington rate base, Staff would remove $585,884 of system rate base for the current assets, inventories and prepayments.

Cash Working Capital, Adjustment 8.11

Q. What does PacifiCorp propose for its working capital needs?

A. PacifiCorp proposes a cash working capital increase of $1,299,091 to its purported working capital balance of $8,605,878 in the unadjusted results. PacifiCorp additionally includes in its unadjusted rate base prepayments, fuel stock, materials and supplies.

Q. How does PacifiCorp calculate its cash working capital?

A. The Company uses a lead-lag method to determine its cash working capital needs.

Q. What is Staff's view of the Company's working capital presentation?

A. The accounts for prepayments, fuel stock, and materials and supplies are current assets. Businesses do not ordinarily have a "working capital" account in their books and records. Working capital is a number derived only for financial analysis. Thus, we contest the Company's direct inclusion of these items in rate base.

Q. What is the regulator's perspective of cash working capital?

A. In rate setting, the issue is whether or not investors supply the funds used for everyday cash flow. If the investors provide funds necessary to run the business economically and efficiently prior to the receipt of payment by customers for service rendered, then a cash working capital requirement exists, and a return on the funds is appropriate. Over the past couple decades Staff has advocated the investor supplied working capital (ISWC) method. The Commission has accepted this method, but also has used other means to calculate working capital to confirm the ISWC approach. Cause Nos. U-75-40, U-77-87, U-79-66, U-80-25, U-81-41, U-81-61, U-83-33, U-85-53, and Docket No. UT-950200.

Q. Could you explain the basic concept of investor supplied working capital?

A. Yes. Broadly speaking, investor supplied working capital may be considered as the average amount of invested capital provided by investors and available for use over and above the average investment in operating and non-operating plant and other specific rate base items. If so, this funding helps bridge the gap between the time expenditures are required to provide services, and the time payments are received from customers. If the investor's capital is used for purposes outside the utility's public service obligations, those purposes are included as non-utility or other investments. In summary, investors are entitled to a return on the working capital *that they provide*.

Q. Who provides working capital besides the investor?

A. Working capital is usually provided by vendors through the terms of their payments, or by ratepayers via various regulatory treatments, such as unamortized investment tax credits or customer deposits.

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

A. The objective is to identify the amount of investor supplied funds in excess of the investments included in rate base. There are two basic assumptions: 1) invested capital is first used for operating and non-operating investments; and 2) operating investments and non-operating investments proratably share any investor-supplied funds.

Q. Did you review PacifiCorp's working capital needs on an investor-supplied basis?

A. Yes. Exhibit ____ (TES-4) shows this analysis.

Q. What is the result of your analysis?

A. My review shows that PacifiCorp has negative investor supplied working capital. In other words, investors are not supplying capital for cash flow needs.

Q. Please explain your exhibit.

A. The basis for my analysis is PacifiCorp's total company balance sheet as of March 31, 2003 on an average of monthly averages basis, as provided by the Company in the supplemental response to Staff Informal Data Request No. 4. The exhibit is organized to show, first, the invested capital (line 8), followed by the operating investments (line 20), non-operating Company investments and other investments (line 32), and total investments (line 34). Total average investments exceed total average invested capital by over $112 million (line 8 less line 34).

Q. What is Staff's adjustment for working capital?

A. Since investor-supplied working capital is a negative balance, working capital items (items normally considered current assets) should be removed from rate base. And, there is no need for the "Working Capital" addition to rate base. Staff removes working capital-related items from the per books rate base. Specifically, Staff reduces rate base by $18,272,643 for prepayments, fuel stock, materials and supplies, working capital, and some miscellaneous deferred credits.

Skookumchuck Sale –Adjustment 8.12

Q. Please explain your proposed adjustment for the Skookumchuck hydroelectric project.

A. The purpose of this adjustment is to portray in the Washington results of operations the sale of the Company's Skookumchuck Dam and hydroelectric project. This is similar to the Company's Adjustments 4.12 and 8.6 regarding the sale of the Naches hydroelectric project. The adjustment removes from the Washington results of operations both operating expenses and rate base items to recognize the impact of the asset sale. This adjustment increases Washington net operating income by $14,091 and decreases Washington rate base by $791,074.

Q. Does the Company have an adjustment in its results of operations presentation for Skookumchuck?

A. No. PacifiCorp filed its general rate case on December 16, 2003, prior to its February 11, 2004, application for an order approving the sale of its interest in the

Skookumchuck Hydroelectric project. The Commission approved the sale on March 12, 2004.

Q. What is the Company's proposal regarding the treatment of the anticipated gain or loss from the sale of the Naches and Skookumchuck projects?

A. In its response to Staff Data Request Nos. 110 and 111, the Company estimates that, from the Naches sale, there will be approximately a $74,000 after-tax gain on a total Company basis, of which approximately $12,457 would be allocated to Washington using the Washington Protocol method. On the other hand, the Company estimates an after-tax loss from the Skookumchuck sale of $68,613 on a total Company basis, of which $10,491 would be allocated to Washington using its Washington Protocol. Under the control area based allocation, the Washington share of the Naches gain and Skookumchuck loss is $16,663 and $15,363, respectively, or a net gain of $1,300. Given that the transactions nearly offset each other, the Company deems that no refund or surcharge is appropriate.

Q. Does Staff agree with the Company proposal?

A. Staff agrees because of the immaterial net amount. However, at this juncture, neither of the property dispositions is finalized. Therefore, the Company should be required to report the final transactions' results and submit a proposal for Commission consideration if the expected and actual results vary.

Customer Deposits – Adjustment 8.13

Q. Please discuss your adjustment for Customer Deposits.

A. This adjustment recognizes the average balance of customer service deposits as a reduction to rate base because they are ratepayer provided funds. Commission rules require the Company to pay interest (currently 1.18%) on customer deposits. The adjustment also treats the interest payments as an operating expense. This presentation compensates the Company for its actual cost on the customer-provided funds and the ratepayers do not pay the full rate of return on the portion of rate base offset by the deposits. This is consistent with this Commission's prior general rate case decisions. Staff's adjustment reduces Washington rate base by $1,029,605, the average balance of interest deposits during the test year, and increases miscellaneous expenses by $12,149.

Miscellaneous Deferred Debits –Adjustment 8.14

Q. Please explain your final adjustment for Miscellaneous Deferred Debits.

A. The following items are included in the Company's unadjusted rate base for Washington as miscellaneous deferred debits: 1) Mill Fork Lease of $2,137,000; 2) Cholla Plant Transaction Costs of $1,509,000; and 3) Mead-Phoenix Transmission Charge of $1,481,000. These items, totaling $5,127,000, should be excluded from Washington rate base because there is no Commission order authorizing their deferral. All of the items also relate to Eastern Control Area plant. The Company indicates its willingness to exclude from rate base item 2, the Cholla Plant Transaction, per its response to Public Counsel Data Request No.131-a.

Q. Do you have any comments on the allocation of overheads as proposed by the Company?

A. Yes, the Company uses a System Overhead (SO) factor to allocate many administrative and general expenses. This allocation factor is determined by the *gross* plant allocated or assigned to the states. Specifically, it is the average of each state's portion of the allocated gross generating plant, gross transmission plant, gross general plant, and gross distribution plant. Only the distribution plant is situs assigned; the others are allocated to the states by various generation-related factors. The term “gross plant” means the nominal amount in capitalized plant accounts, not the unamortized balance after taking into account the accumulated depreciation of the plant. Production and transmission plant is allocated on energy consumption and capacity of the various states. Mr. Buckley presents reasons to reject this method of allocating production and transmission plant. By the same token, Staff cannot accept an allocation factor for overhead that is the simple application of allocated plant accounts. This is one more example of the inadequacy of PacifiCorp’s proposed allocation scheme. More work is needed to refine the allocation or assignment of costs to Washington, as Mr. Buckley testifies.

Q. Does this conclude your testimony?

A. Yes.