

Exhibit ___ T (TES-1T)
Docket UE-061546/UE-060817
Witness: Thomas E. Schooley

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Complainant,

vs.

PACIFICORP dba Pacific Power & Light
Company,

Respondent.

DOCKET UE-061546

In the Matter of the Petition of

PACIFIC POWER & LIGHT COMPANY

For an Accounting Order Approving Deferral
of Certain Costs Related to the MidAmerican
Energy Holdings Company Transition.

DOCKET UE-060817

TESTIMONY OF

Thomas E. Schooley

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Results of Operations and Accounting Petition

February 16, 2007

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LIST OF EXHIBITS

- Exhibit No. ___ (TES-2): Revenue Requirements Presentation
- Exhibit No. ___ (TES-3): Investor-supplied Working Capital
- Exhibit No. ___ (TES-4): Lead-Lag
- Exhibit No. ___ (TES-5): Adjustment 8.13, MEHC Transition Savings
- Exhibit No. ___ (TES-6C): Confidential Severance Expense Detail
- Exhibit No. ___ (TES-7): PacifiCorp Petition to defer MEHC Transition costs,
Docket UE-060817

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Thomas E. Schooley. My business address is 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504. My email address is tschoole@wutc.wa.gov.

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

A. I am employed by the Washington Utilities and Transportation Commission (the Commission) as a Regulatory Analyst.

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

A. Since September 1991.

Q. What are your professional qualifications?

A. I am employed by the Washington Utilities and Transportation Commission ("the Commission") since 1991 as a Regulatory Analyst. 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.

1 I testified in Docket UE-960195 involving the merger between Washington
2 Natural Gas Company and Puget Sound Power & Light Company. I was the lead
3 Staff analyst in several applications for accounting treatment, including Puget Sound
4 Energy, Inc. ("Puget") Dockets UE-971619 and UE-991918. I testified in the Avista
5 general rate case, Docket UE-991606, and Avista's energy recovery mechanism,
6 Dockets UE-000972, UE-010395, UE-011595, and UE-030751. I also assisted in the
7 development of Staff testimony in Puget's "PRAM 2" case, Docket UE-920630, and
8 I presented the Staff recommendation on environmental remediation in Puget Docket
9 UE-911476.

10 I analyzed PacifiCorp's proposed accounting treatment of Clean Air Act
11 allowances in Docket UE-940947, and participated in meetings of PacifiCorp's inter-
12 jurisdictional task force on allocations. Most recently I testified in Puget's power
13 cost only rate case, Docket UE-031725, and in PacifiCorp's general rate cases,
14 Dockets UE-032065 and UE-050684 et al.

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

18
19 **Q. Did you participate in PacifiCorp's last general rate case?**

20 **A.** Yes. I was the lead accounting witness for the Commission Staff in PacifiCorp's last
21 general rate case, Docket UE-050684, et al. I refer to that case as the "2005 Rate
22 Case." That case was resolved in July 2006. Consequently, in the current case, Staff

1 was already quite familiar with the Company's books of account and most of the
2 ratemaking issues presented in this case.

3
4 **II. SCOPE OF TESTIMONY**

5
6 **Q. What is the scope of your testimony?**

7 A. I present the results of Staff's analysis of PacifiCorp's Washington Results of
8 Operations, restated for known and measurable changes, including Staff's calculation
9 of the revenue change for PacifiCorp based on that Results of Operations.

10 I identify the Company adjustments that Staff reviewed and does not contest.
11 I testify to several of PacifiCorp's adjustments which Staff contests. I also address
12 several additional adjustments proposed by Staff that the Company did not include in
13 its direct case.

14
15 **Q. In addition to incorporating the adjustments and analyses of other witnesses**
16 **testifying on behalf of Commission Staff, what specific adjustments do you**
17 **address?**

18 A. I present testimony on the following adjustments: [verify numbering!]

- 19 • Adjustment 4.4, Out-of-Period Expenses;
20 • Adjustment 4.10, Pro forma Wages;
21 • Adjustment 7.10, Domestic Production Activity Tax Change;
22 • Working Capital Adjustments:
23 ○ Adjustment 8.1, Cash Working Capital;

1 The basis for Staff's revenue recommendation is detailed in my Exhibit ____
2 (TES-2). Page 3 of that exhibit is a summary of the revenue requirements
3 calculation. The 5.4 percent increase is shown on page 1 at the top of column 4.
4

5 **Q. What capital structure and cost rates of capital are used in Staff's revenue**
6 **requirement determination?**

7 A. Staff's revenue requirement determination is based on the capital structure and cost
8 rates of capital recommended by Staff witness Mr. Ken Elgin. *See Section IV of the*
9 *direct testimony of Kenneth L. Elgin, Exhibit ____ (KLE-1T).*
10

11 **Q. Please explain the format of Exhibit ____ (TES-2).**

12 A. Staff's revenue requirement calculation begins with the Company's per books
13 results, as shown on page 1, column 1 of my exhibit. This is the same as the
14 Company's starting point, found in Company witness Mr. Wrigley's Exhibit ____
15 (PMW-4), Tab 2.

16 Each adjustment is itemized on pages 7-14 of Exhibit ____ (TES-2), using the
17 same numbering system and names as the Company uses in Exhibit ____ (PMW-4),
18 except Staff adds adjustment numbers and names for Staff's proposed adjustments. I
19 provide a more detailed description of my Exhibit ____ (TES-2) in the Appendix on
20 page 17.

21 My Exhibit ____ (TES-2) also contains six tables, on pages 18-23. Table 1
22 shows the net operating income (NOI) effect of each adjustment, and Table 2 shows
23 the net rate base impact. Table 3 is the rate of return calculation I received from

1 Staff witness Mr. Ken Elgin. Table 4 calculates the conversion factor. Table 5
2 calculates Staff's recommended increase in NOI, and Table 6 calculates the increase
3 in revenue requirements and percentage rate increase.
4

5 **IV. TEST YEAR AND RATE YEAR**
6

7 **Q. What is the period of time covered in Staff's analysis?**

8 A. Staff's analysis covers the twelve months ending March 2006. This period is known
9 as the "test year." The results of operations for that period are adjusted for known
10 and measurable changes which may occur prior to the effective date of the new rates.
11 This period, beginning about September 2007, is known as the "rate year."

12
13 **Q. Are these the same test year and rate year PacifiCorp uses in its direct
14 testimony?**

15 A. Yes.
16

17 **Q. What is the importance of the test year?**

18 A. A basic premise of the ratemaking process is to establish the relationship between
19 revenues, expenses, and rate base. Each of these components must be measured over
20 the same time period. Another premise is that the revenues and major variable costs
21 are both based on "normal" temperatures and hydro-production conditions. To
22 achieve consistency in presentations and to assure that timely information is used,

1 there must be agreement on a recent baseline of data. That time period is the "test
2 year."

3
4 **Q. What is the "rate year" measurement?**

5 A. New rates will be effective at a date in the near future. Therefore, it is appropriate to
6 adjust the test year results to reflect known changes in the price levels, assuming
7 there are no offsetting circumstances. For example, if the Company signs a new
8 union contract after the test year, the new wage rates included on that contract would
9 be used to adjust the test year wages for those employees. However, the increases
10 are applied to the same level of hours worked during the test year, unless there is a
11 known and measurable change in work levels.

12
13 **V. ADJUSTMENTS**

14
15 **A. Uncontested Adjustments**

16
17 **Q. Does Staff accept any of the Company's proposed adjustments?**

18 A. Yes. Staff accepts most of PacifiCorp's proposed adjustments. In my Exhibit ____
19 (TES-2), pages 25-26, Summary of Adjustments, I mark each uncontested
20 adjustment with the symbol "(u)".

21 Staff examined these adjustments, conducted discovery, and concluded that
22 each of these adjustments is reasonable in principle and calculation. However, Staff

1 reserves the right to challenge any of these adjustments if additional information or
2 changed circumstances warrants that.

3
4 **Q. If Staff accepts most of the Company's proposed adjustments, why are there**
5 **small variances in the "Differences" column of Exhibit ___ (TES-2), pages 25-**
6 **26?**

7 A. These small variances are not due to a dispute regarding the substance of the
8 adjustment. They are caused by Staff's use of a slightly different conversion factor
9 than PacifiCorp used. PacifiCorp inadvertently omitted the WUTC regulatory fee in
10 its calculation of the conversion factor. Staff corrects this error. All adjustments are
11 impacted slightly. The calculation of the conversion factor is on page 4 of my
12 Exhibit ___ (TES-2).

13
14 **Q. In the 2005 Rate Case, Staff identified certain miscellaneous general expenses**
15 **that should not be recovered through rates. Did the Company remove such**
16 **expenses in the current case?**

17 A. Yes. The Company removed the expenses that were identified in the previous rate
18 case that the Company should have been expensed "below the line" and charged to
19 non-regulated activities. These are shown in Adjustment 4.2, Miscellaneous General
20 Expense.

21
22 **Q. Did Staff perform its own analysis of those accounts?**

23 A. Yes.

1 **Q. What miscellaneous general expense accounts did Staff review?**

2 **A.** Staff reviewed Account 921, Office Supplies and Expense; Account 923, Outside
3 Services Employed; and Account 930, Miscellaneous General Expenses.
4

5 **Q. How did Staff analyze these accounts?**

6 **A.** Due to the voluminous data in accounts 921, 923 and 930, we took a sample from the
7 months of October and November 2005.
8

9 **Q. Were you satisfied that the Company properly recorded its expenses in the**
10 **sampled months?**

11 **A.** Yes, the Company either properly recorded expenses, or removed the expenses in its
12 Adjustment 4.2.
13

14 **Q. Another dispute in the 2005 Rate Case concerned the ratemaking treatment of**
15 **Edison Electric Institute (EEI) dues. How did PacifiCorp treat EEI dues in this**
16 **case?**

17 **A.** Staff understands that the parent company, MEHC, is the member of EEI, and
18 MEHC deducts 25% of the EEI dues before allocating the rest to its operating
19 companies. This treatment is a reasonable.
20

1 **B. Adjustment 4.4, Out of Period Expenses**

2
3 **Q. Please explain the first contested adjustment, Adjustment 4.4, Out of Period**
4 **Expenses.**

5 A. This is a restating adjustment to remove an expense that does not apply to the test
6 year. Staff revised the Company Adjustment 4.4 to account for a liability reserve
7 that impacted the income statement during the test year. This item relates to a right-
8 of-way on tribal lands of the Yellowtail tribe that the Company used prior to the test
9 year.

10 In response to Staff Data Request 70, the Company acknowledged it is
11 appropriate to make this additional out of period restating adjustment. This
12 adjustment reduces Washington allocated operating expenses by \$259,238, and
13 reduces revenue requirements by \$271,734.

14
15 **C. Adjustment 4.10, Pro Forma Wages**

16
17 **Q. Please explain Adjustment 4.10, Pro Forma Wages.**

18 A. PacifiCorp intentionally left out of its direct case a pro forma adjustment for wage
19 increases that will occur in the near future. In its response to Staff Data Request 54,
20 the Company shows a \$1,070,000 increase in non-executive wages by the end of
21 2007.

22 This is a proper pro forma adjustment because it reflects known and
23 measurable changes in wages, applied to test year work levels. Staff therefore

1 proposes an increase in wage expense of \$1,070,000, which increases revenue
2 requirements by about \$1.12 million.
3

4 **D. Power Supply Adjustments: Adjustment 5.4, Miscellaneous Power Supply;**
5 **Adjustment 5.5, Revised CAGW & SO Allocators, and Adjustment 5.6, Water**
6 **Year Adjustment**
7

8 **Q. What are Staff's contested power supply-related adjustments?**

9 A. Staff proposes three power supply-related Adjustments. The first adjustment is
10 Adjustment 5.4, Miscellaneous Power Supply. It is comprised of four changes to the
11 Company's power supply presentation. The second adjustment is Adjustment 5.5,
12 Revised CAGW and SO Allocators (System Operations). This adjustment affects
13 the allocation of production plant and administration and general costs under the
14 Western Control Area methodology. The third adjustment is Adjustment 5.6, Water
15 Year Adjustment. This adjustment is related to Staff's proposed PCAM.

16 These adjustments are shown in my Exhibit ____ (TES-2) at pages 13-14.

17 Staff witness Mr. Alan Buckley is responsible for the theory and calculation of
18 adjustments 5.4 and 5.6, and the theory for Adjustment 5.5. I am responsible for the
19 calculation of Adjustment 5.5.
20

21 **Q. How did you determine the dollar amounts for the impact of the change in the**
22 **CAGW and SO allocation factors in Adjustment 5.5?**

23 A. In its response to ICNU's Data Request 2.4, PacifiCorp revised its revenue
24 requirements to incorporate an allocation factor termed "Control Area Generation
25 West, (CAGW)." Generation and transmission plant is allocated on the CAGW

1 factor. This factor is based on 75% of the average of 12 coincidental peaks for the
2 Western control area states, and 25% of the energy for those states. It is similar to
3 the calculation of the System Generation factor for all six states. The response to the
4 ICNU Data Request 2.4 is a revision to page 1 of Exhibit ___ (PMW-4). As the
5 Company's System Operations (SO) allocation factor is based on the plant allocated
6 to each state, the SO factor changed as a consequence of the revised allocation of
7 generation and transmission plant.

8 Staff's Adjustment 5.5 is the difference between each account in those two
9 versions of the Company's adjusted results. The adjustment reduces revenue
10 requirements about \$2.2 million.

11
12 **E. Adjustment 7.6, IRS Settlement**

13
14 **Q. Please identify Adjustment 7.6, concerning an IRS Settlement.**

15 A. Staff removes PacifiCorp's proposed Adjustment 7.6, IRS Settlement. Staff witness
16 Mr. Danny Kermod provides the reasons. This adjustment reduces revenue
17 requirements about \$1,083,000.

18
19 **F. Adjustment 7.10, Production Tax Change**

20
21 **Q. Please explain Adjustment 7.10, Production Tax Change.**

22 A. This Staff adjustment implements the estimated impact of the higher percentage rate
23 of the tax deduction for qualified domestic production activities provided under the

1 American Jobs Creation Act of 2004 (“the Act”). Under the Act, PacifiCorp was
2 able to deduct from its taxable income three percent of the electric generation
3 activity income in 2005 and 2006. However, the tax credit rate increases to six
4 percent for tax years 2007 through 2009, and to nine percent after that.

5 Staff used the six percent rate in its adjustment, which is twice the rate used
6 in the determination of the Company’s per books federal income tax expense (FIT);
7 detailed in the Company response to Staff Data Request 33. The tax credit rate of six
8 percent is a known and measurable change to the test year expense. Therefore, an
9 adjustment should be made using the six percent rate. The impact of this rate change
10 reduces the Washington allocated FIT expense by \$184,798, and reduces revenue
11 requirement about \$300,000.

12
13 **G. Working Capital Adjustments: Adjustment 8.1, Remove Cash Working**
14 **Capital; Adjustment 8.3, Jim Bridger Mine Rate Base; Adjustment 8.14,**
15 **Remove Per Books Working Capital; Adjustment 8.15, Remove Current Assets;**
16 **and Adjustment 8.16, Investor-supplied Working Capital.**
17

18 **Q. What amounts does PacifiCorp include in its direct case related to working**
19 **capital?**

20 A. PacifiCorp proposes a cash working capital increase of \$175,850 to its unadjusted
21 working capital balance of \$4,014,806. To this amount, PacifiCorp adds
22 \$12,166,362 to its unadjusted rate base for items called “prepayments,” “fuel stock,”
23 and “materials and supplies.” *Exhibit No. ____ (PMW-4) Tab 2, page 2.2, lines 41-*
24 *44.* The result is a total working capital-related adjustment for the Company that
25 adds over \$16.3 million to the Washington rate base.

1 **Q. What is cash working capital?**

2 A. Cash working capital refers to the funds necessary to sustain a company in its day to
3 day operations.

4

5 **Q. What is the ratemaking perspective on cash working capital?**

6 A. In rate setting, the goal is to directly measure whether or not investors actually
7 supply working capital. If they do, it is appropriate to apply a return on the amount
8 of working capital the investors supply.

9

10 **Q. What did the Commission say about working capital in the 2005 Rate Case?**

11 A. The Commission stated: "the objective is to quantify the amount of working capital
12 and current assets supported by capital on which investors are entitled to a return."

13 The Commission also said: "We [the commission] also expect Staff and other parties
14 to provide full evidentiary support of any proposals and methods they may submit to
15 substantiate adjustments to a company's figures." *Docket UE-050684, Order 04 at*
16 ¶¶ 188-189.

17

18 **Q. Has Staff attempted to provide the Commission with full evidentiary support
19 for Staff's proposed working capital adjustment?**

20 A. Yes. In addition to my testimony, I provide Exhibit ____ (TES-3), which is a
21 complete working capital calculation, with all accounts listed.

22

1 **Q. What method does Staff propose for measuring working capital?**

2 A. Staff proposes the Commission use the same method Staff proposed in the 2005 Rate
3 Case: the investor-supplied working capital method.
4

5 **Q. What is the basic concept of the investor-supplied working capital method?**

6 A. Broadly speaking, the investor-supplied working capital method measures the
7 difference between the capital invested in a business and the investments in the
8 business. In other words, investor-supplied working capital is the amount of
9 invested capital that was provided by investors and available for the company's use,
10 over and above the company's investments in operating plant, non-operating plant,
11 and other specific items of investment.

12 If there is an excess of invested capital over investments, that amount is
13 investor-supplied working capital.

14 In summary, the investor-supplied working capital method directly measures
15 the amount of working capital that investors provide. If there is such an amount, it is
16 included in rate base and earns a return.
17

18 **Q. Who provides working capital besides the investor?**

19 A. Working capital is typically provided by trade creditors through the terms of their
20 payments. For example, most trade creditors allow PacifiCorp to pay for goods or
21 services rendered 30 days from the date the goods or services were delivered.² The
22 Company has use of those funds during that period. Working capital may also be

² Exhibit ___ (PMW-5), at 4.2.2.

1 provided by ratepayers or non-investors, via various regulatory treatments, such as
2 deferred income taxes, unamortized investment tax credits, or customer deposits.
3

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

5 A. As I explained, the objective is to identify the amount of investor supplied funds in
6 excess of the investments. There are two basic assumptions: 1) invested capital is
7 used for both operating and non-operating investments; and 2) the operating
8 investments and non-operating investments share pro-ratably any excess investor-
9 supplied funds.
10

11 **Q. What are the results of Staff's investor-supplied working capital analysis in**
12 **Exhibit ___ (TES-3)?**

13 A. Exhibit ___ (TES-3) shows that PacifiCorp has an excess of investor-supplied capital
14 over investments of approximately \$129 million. In other words, investors are
15 supplying capital for the Company's cash flow needs. Non-operating investments
16 are about 12.5% of the total and pro-ratably share the working capital. Therefore,
17 investors supply \$112.7 million of working capital for utility operations. Of that
18 amount, Washington is allocated \$8.3 million, based on the system operations
19 allocation factor.
20

1 **Q. Please explain your exhibit.**

2 A. The basis for my analysis is PacifiCorp's total company balance sheet as of March
3 31, 2006, on an average of monthly averages basis, as provided by the Company in
4 its Response to Staff Data Requests 26 and 89.

5 Page 1 of the exhibit shows the total invested capital on line 15. The
6 operating investments are shown on page 2 on line 70. Non-operating and other
7 investments are on page 3 at line 112, and the sum of the total investments is shown
8 on line 114.

9 Page 3, line 116 shows the investor-supplied working capital (ISWC), which
10 is calculated by subtracting the total investments from the total invested capital (line
11 15 less line 114). As shown on line 114, the ISWC is a positive \$128,908,638.

12 The "source" column of pages 1 and 2 shows the source of the data from
13 pages 3 through 6 of my exhibit, or from Exhibit ____ (PMW-4).

14

15 **Q. In PacifiCorp's 2005 Rate Case, Staff's ISWC calculation showed a negative**
16 **\$16 million. Now, Staff has determined the ISWC is a positive \$129 million. Is**
17 **this a remarkable change in one and one-half years?**

18 A. No; not in light of the changes in the Company's balance sheet. The change in
19 Staff's ISWC of \$145 million represents about a two percent increase when
20 compared to the September 2004 investments of about \$7.3 billion. Other increases
21 in PacifiCorp's balance sheet from September 2004 to March 2006 show the
22 following:

23 An increase in total assets and other debits of over 12%,
24 An increase in net utility plant of 8.3%, and

1 An increase in total capitalization (debt plus equity) of nine percent.

2 This two percent increase in working capital is reasonable compared to the growth in
3 total Company operations.

4
5 **Q. How does PacifiCorp calculate its working capital adjustment?**

6 A. The Company uses a "lead-lag" method to determine its cash working capital needs.
7 In addition, as I mentioned earlier, the Company directly includes in rate base
8 separate, additional amounts of working capital called prepayments, fuel stock, and
9 materials and supplies.

10
11 **Q. Is the Company's working capital presentation appropriate?**

12 A. No. PacifiCorp presents "working capital" amounts in its results of operations as if
13 these amounts are accounts in the Company's books and records. However, the
14 Company does not include these amounts on its books. *See Exhibit No. ____ (PMW-*
15 *4) Tab 2, page 2.2, line 44.* In fact, working capital is a derived number used for
16 financial analysis, or as an adjustment to the results of operations for ratemaking
17 purposes. The Company errs by including working capital items as per books rate
18 base items.

19
20 **Q. What specific accounts does the Company directly include in rate base as
21 working capital items?**

22 A. The Company includes in rate base amounts for prepayments, fuel stock, and
23 material & supplies, as shown in Company Exhibit ____ (PMW-4) Tab 2, page 2.2,

1 lines 41-43. These are current assets, as shown in the Company's Response to Staff
2 Data Request 26. As such, these items should only be included in working capital to
3 the extent investor's supply that capital. These items should not be automatically
4 included as line item rate base accounts, as PacifiCorp presents them.
5

6 **Q. Are investors supplying capital related to prepayments, fuel stock, and material
7 & supplies?**

8 A. As Staff's analysis shows, PacifiCorp investors do contribute funds to working
9 capital. Staff includes that contribution in rate base. However, to directly include in
10 rate base the items, prepayments, fuel stock, and material & supplies would double
11 count them, because they are included in the investor-supplied calculation as
12 working capital.
13

14 **Q. How do Staff's adjustments address the Company's working capital adjustment
15 and the current assets, such as prepayments, fuel stock, and material &
16 supplies?**

17 A. Staff's Adjustment 8.14 removes from "unadjusted results" PacifiCorp's "working
18 capital" amount of \$4,014,806, and Staff zeros out PacifiCorp's Adjustment 8.1,
19 which is the Company's update to cash working capital. Staff's Adjustment 8.15
20 removes from rate base \$12,166,362, which is the total of the current asset accounts
21 containing "prepayments," "fuel stock," and "materials and supplies." *Exhibit* ____
22 *(TES-2), at pages 18 and 22.*
23

1 **Q. Do other PacifiCorp adjustments include working capital-related components?**

2 A. Yes. In Company Adjustment 8.3, Jim Bridger Mine Rate Base, PacifiCorp included
3 accounts which are considered current assets. Accordingly, Staff reduced this
4 adjustment by \$1,681,154 (Washington) for materials & supplies, inventory, and
5 prepayments related to the Jim Bridger Mine. *See Exhibit No. ____ (PMW-4), Tab 8,*
6 *page 8.3.1*

7 In the ISWC determination, Staff transfers these Jim Bridger Mine assets to
8 “operating investments” from “non-operating investments,” and includes the current
9 assets of the mine as working capital. This properly accounts for the working capital
10 of the mining operation.

11

12 **Q. In PacifiCorp’s 2005 Rate Case, did the Company challenge the validity of**
13 **Staff’s investor supplied working capital method?**

14 A. Yes. The Company made three challenges. First, the Company relied on a textbook
15 named *Accounting for Public Utilities* by Mr. Robert Hahne, which criticized some
16 type of balance sheet method for calculating working capital. Next, the Company
17 compared Staff’s calculation in that case to a prior Staff calculation, and identified
18 certain inconsistencies. Finally, the Company charged that Washington is the only
19 state that uses a balance sheet method to calculate working capital.

20

21 **Q. Were the Company’s criticisms valid?**

22 A. No.

23

1 Q. Please explain why the Company's use of Mr. Hahne's textbook is not valid.

2 A. The primary problem is that PacifiCorp cannot show that the method Mr. Hahne was
3 addressing in his textbook is the same as the method Staff used in this case, and has
4 for the past several decades.³

5 For example, Mr. Hahne states that the balance sheet method wrongly
6 assumes that all non-utility or non-jurisdictional assets are investor-supplied.⁴
7 However, Staff's method does not make that assumption. Staff appropriately
8 allocates working capital between utility and non-utility operations. Notably,
9 PacifiCorp could neither explain the materiality of Mr. Hahne's statement, nor where
10 in Staff's analysis the assumption described by Mr. Hahne is manifested. *See*
11 *PacifiCorp's witness Mr. Wrigley's testimony in the 2005 Rate Case at Tr. 470:16-*
12 *471:15 and Tr. 471:16-472:18.*

13 The Company also relied on Mr. Hahne's statement that the balance sheet
14 method is problematic if the utility does not record unbilled revenues.⁵ However,
15 PacifiCorp records unbilled revenues, so this criticism, has no application to
16 PacifiCorp, assuming it is a valid criticism.

17 Finally, the Company relied on Mr. Hahne's criticism that the balance sheet
18 is a "snap shot of completed series of events," and his complaint that even an
19 average of 13 months misses the payment of expenditures made on the first day of
20 the month.⁶ However, Staff's investor-supplied working capital analysis reflects an

³ Staff traced the ISWC approach as far back as the early 1960s.

⁴ Exhibit ___ (PMW-5) at 6.2.7.

⁵ Exhibit ___ (PMW-5) at 6.2.8.

⁶ Exhibit ___ (PMW-5) at 6.2.9.

1 average of the monthly average data, thereby picking up balances that may be missed
2 by only one "snapshot" per month.

3
4 **Q. Please explain why the Company's second challenge, its comparisons to a prior**
5 **Staff working capital calculation, is not valid.**

6 A. Many of the Company's criticisms are in form only because most of the differences
7 between the two Staff calculations did not change the bottom line result. For certain
8 other differences, the Staff's prior calculation did indeed contain some errors, which
9 Staff corrected in its calculation in the 2005 Rate Case. It is also worthwhile to note
10 that the earlier docket which the Company used for its comparison was settled before
11 a hearing on the merits. Consequently, it is possible Staff could have made
12 corrections to its exhibit in that case had it gone to hearing.

13
14 **Q. Is it remarkable that Staff's ISWC presentation might be different in different**
15 **cases?**

16 A. No. Staff works to present a complete analysis in each case. Staff discovers
17 improvements and refinements along the way. At the same time, evolving
18 requirements of Generally Accepted Accounting Principles have increased the
19 complexity of corporate balance sheets considerably over time. However, the
20 overriding principle stays the same: only the working capital provided by investors
21 may be included in rate base.

1 **Q. Is the Company correct that Washington is the only state that uses a balance**
2 **sheet approach to calculate investor supplied working capital?**

3 A. No. At least three other states currently use a balance sheet method: Idaho,
4 Michigan, and Florida.⁷ Moreover, there are various methods of calculating working
5 capital in current use. Some states use the FERC formula method. Wisconsin uses a
6 form of balance sheet approach, adjusting rate of return by a ratio of rate base to
7 capital less non-utility accounts. Many states use a lead-lag study, but with different
8 treatments of leads and lags. The inclusion of materials and supplies, prepaid
9 accounts or fuel stock also varies from state to state. Some states simply do not
10 include working capital in rate base.

11 In other words, it would not be valid to suggest that a lead-lag study is the
12 only accepted method of measuring working capital.

13 Moreover, the goal should be to use consistently a method that is
14 theoretically defensible, is not overly complex, and calculates the amount of working
15 capital supplied by investors. The Company should include in rate base only the
16 amount of working capital supplied by investors. Staff's approach satisfies this goal.
17 The Company's method does not.

18
19 **Q. Why does the Company's method fail to satisfy this goal?**

20 A. As I described earlier, the Company relies upon a lead-lag study to measure working
21 capital. The inch thick document supporting this study contains a plethora of detail,

⁷ Michigan PSC: *In re Consumers Energy Company*, Case U-14547, Opinion and Order (September 21, 2006) at 7-10; Florida PSC: *In re Progress Energy Florida*, Docket 050078-EI, Document 04220-05 at 19 (Sch. B-1), 22 (Sch. B-2) and 160 (Sch. B-17). My statement regarding Idaho is based on information provided by the Idaho PUC Staff.

1 but in the end it makes a simple comparison: it compares the turnover in accounts
2 receivable to the turnover in accounts payable. Stated another way, the lead-lag
3 study compares the time it takes the Company to collect the money due to it, versus
4 the time the Company takes to pay its bills. If the study finds the bill collection takes
5 longer than the bill payments, the Company receives a reward: the difference is
6 added to rate base and earns an 8% return.

7
8 **Q. Does the PacifiCorp's lead lag method provide proper incentives to the**
9 **Company?**

10 A. No. The Company's method provides the Company the economic incentive to slow
11 down the collection of money and to speed up the payment of bills.

12
13 **Q. Do you find evidence that the Company may be acting on this incentive?**

14 A. Yes. The expense lag section of Exhibit ___ (PMW-5) presents the Company's
15 calculation of its lag days for accounts payable using April 2002 as an example.
16 Pages 4.2.4-1 and 4.2.4-2 are the first and last pages of all payments made that April.
17 The relevant columns are those labeled "voice Date," "Paid Date" and "Total Lag
18 IDCD."⁸

19 The Total Lag column is the number of days between the invoice date and the
20 paid date. The data shows a total of 120 invoices of which 115 have a payment term
21 of "net 30." In other words, the Company has 30 days to pay this bill. Of the 115
22 net 30 invoices, 64 (over 55%) were paid earlier than the 30 days allowed, with 36 of

⁸ "Voice date" is truncated from Invoice Date.

1 those paid in 26 days. If those 64 invoices were paid on the 30th day, the number of
2 lag days for this sample would decrease by two days. This indicates it is the
3 corporate practice to pay invoices sooner than required. My Exhibit ___ (TES-4)
4 illustrates this data, which I summarize at the bottom of page 3 of that exhibit.
5

6 **Q. Is the Company's analysis of expense lags purely factual?**

7 A. No. The Company makes assumptions about the receipt of goods and about the days
8 for the payments to clear its cash account.⁹ For example, the Company assumes the
9 invoice date is the same date goods or services were received. This is not necessarily
10 true. The Company also assumes the date of the check is the date the cash
11 disappears from its cash accounts. This assumption may be valid for large
12 transactions paid by wire transfers. However, many of the transactions listed on
13 pages 4.2.4-1 and 4.2.4-2 are too small to warrant a wire transfer. Consequently,
14 there is a lag from the date the check is cut to the date it clears the Company's bank
15 account. This introduces an improper bias towards a shorter lag time for the
16 expenses.
17

18 **Q. What are your conclusions regarding the working capital adjustment?**

19 A. For the reasons I have stated, the Commission should use the investor-supplied
20 working capital method for calculating working capital.

21 First, the Commission should reject the lead lag study offered by PacifiCorp,
22 and also remove the current asset accounts prepayments, fuel stock, and materials

⁹ Exhibit ___ (PMW-5) at 4.0.1, near end of the first paragraph.

1 and supplies from the results of operations, including the current asset account from
2 Adjustment 8.3, Jim Bridger Mine. This results in a reduction to rate base of
3 \$18,038,172.

4 Second, the Commission should accept Staff's ISWC calculation, which adds
5 back \$8,321,198 million to rate base. The net effect of the working capital rate base
6 adjustments is to reduce revenue requirements by approximately \$1.26 million.

7
8 **H. Adjustment 8.13, MEHC Transition Savings, And Accounting Petition**

9
10 *1. Nature of the Adjustment*

11
12 **Q. What is involved in the Company's Adjustment 8.13, MEHC Transition**
13 **Savings?**

14 **A.** This adjustment implements the relief sought by PacifiCorp through its accounting
15 petition in Docket UE-060817. The Company filed that petition on May 19, 2006.
16 The costs and savings at issue relate to severance payments and benefits the
17 Company gave to departing employees as a result of the March 2006 acquisition of
18 PacifiCorp by MidAmerican Energy Holdings Company (MEHC). The adjustment
19 also involves software conversion costs the Company incurred in changing its fiscal
20 year.

21 The Company's adjustment reflects a proposed three year amortization of
22 these costs. *See Mr. Wrigley's direct testimony, Exhibit ___ (PMW-1T) at 22, and*
23 *Exhibit ___ (PMW-4), Tab 8, at 8.13-8.13.3.*

1 2. *Summary of Staff's recommendations*

2
3 **Q. Please summarize Staff's recommendations for the treatment of transition costs**
4 **in both Docket UE-061546, the rate case, and Docket UE-060817, the accounting**
5 **petition.**

6 **A. Staff recommends the Commission grant the Company's petition in part, and reflect**
7 **that relief in this rate case, as follows:**

8 1. The expense associated with Company employees notified of
9 displacement prior to May 2006 should be excluded from the deferred balance.

10 2. The expense of employees who were notified of displacement in May
11 2006 or later and received benefits under the Executive Severance Plan, should be
12 reduced to the same percentage as the benefits received by employees under the plan
13 for non-executives; the Change-in-Control Plan.

14 3. The expenses of the employees notified of displacement in May 2006,
15 or later, as adjusted in my Recommendation 2, should be deferred and amortized
16 over three years. The amortization should begin in the month rates are in effect in
17 this general rate case, Docket UE-061546.

18 4. The Commission should reject the Company's request to defer the
19 expenses of PacifiCorp's converting to a fiscal calendar year.

20 5. The Company should record a beginning deferral balance of transition
21 costs in the amount of \$1,911,142 in Account 182.3, Other Regulatory Assets. The
22 Commission should allow a three-year amortization of this amount, or \$637,047
23 annually, using Account 930.2, Miscellaneous General Expenses, upon inclusion in

1 rates. These are Washington amounts, and they are shown in my Exhibit ____ (TES-
2 5), at 1, lines 17 & 19.

3 6. The unamortized balance of transition costs may be included in rate
4 base, but only to the extent it contributes to working capital supplied by investors.
5 The balance should exclude the accrual of a carrying charge on the deferred balance.

6
7 3. *The Company's petition in Docket UE-060817*

8
9 **Q. Have you included as an exhibit a copy of PacifiCorp's petition in Docket UE-**
10 **060817?**

11 **A.** Yes. It is my Exhibit ____ (TES-7).

12
13 **Q. Please describe the Company's petition.**

14 **A.** PacifiCorp filed the accounting petition on May 19, 2006. PacifiCorp seeks a
15 Commission accounting order authorizing the Company to capitalize certain
16 expenses relating to the acquisition of the Company by MidAmerican Energy
17 Holdings Company ("MEHC"). *Exhibit ____ (TES-7), Petition at 2-3, ¶¶ 7-8.* The
18 Company seeks approval to charge these costs to Account 182.3, Other Regulatory
19 Assets, and amortize them to Account 930.2, Miscellaneous General Expenses upon
20 inclusion in rates. *Exhibit ____ (TES-7), Petition at 3, ¶ 8.*

21 The Commission has yet to approve the Company's petition. The
22 Commission consolidated the petition docket with the general rate case docket.

1 4. *Detailed description of the transition costs at issue*

2
3 **Q. What specific types of costs, numbers of employees and amounts does the**
4 **Company include as “transition costs?”**

5 A. Primarily, these costs consist of the severance payments and other benefits
6 PacifiCorp paid to departing employees when the Company reduced its labor force
7 as a consequence of the MEHC acquisition. That acquisition was completed in
8 March 2006. The Company first announced layoffs soon after the acquisition, and
9 layoffs will continue until Spring 2007.

10 In addition to a cash payment, these costs include expenses for outplacement
11 services, continuing medical insurance, and payroll taxes. In responses to data
12 requests, the Company stated that severance expenses were \$27,893,000, for 168
13 employees. More recent data shows that as of December 31, 2006, there are 241
14 terminated employees with total company severance pay equaling \$42,883,385.

15 *E.g., PacifiCorp’s Response to ICNU Data Request 6.4.*

16 My Confidential Exhibit ____ (TES-6C) is the confidential attachment to
17 PacifiCorp’s response to ICNU Data Request 6.4. This exhibit contains a complete
18 list of all positions the Company eliminated, and the related severance amounts the
19 Company paid, by position.

20
21 **Q. Does the Company request deferred treatment for any other expenses?**

22 A. Yes. A relatively small amount of the transition costs relate to the cost the Company
23 incurred to convert its software to reflect a change in the Company’s fiscal year to a

1 year ending December 31, from March 31. The Company originally estimated this
2 expense as \$0.5 to \$1.0 million, total company. *Exhibit ___ (TES-7), Petition at 3, ¶*
3 *6.*

4
5 **Q. Were all severed Company employees offered the same severance package?**

6 A. No. There were two plans available. Only a select few employees were eligible for
7 the "Executive Severance Plan." Everyone else received benefits under a "Change-
8 in-Control Plan."

9
10 **Q. Please explain the basic provisions of these two plans.**

11 A. Each plan provides benefits which include wage-related cash payments, continuation
12 of medical benefits, and outplacement services. The medical benefits clauses are
13 similar between the plans.

14 The major differences between the plans are the levels of cash benefits and
15 outplacement benefits that were awarded departing employees. The Executive
16 Severance Plan provides significantly higher cash benefits and outplacement
17 services.

18 For example, the Executive Severance Plan provides cash payments of two to
19 three times the departing executive's annual wages, plus a minimum of twelve
20 months of outplacement services. By contrast, the Change-in-Control Plan provides
21 up to a half year base pay, plus up to three weeks base pay times the years of service,
22 with a maximum payout of two times annual compensation. The Change-in-Control
23 Plan also provides up to a maximum of six months outplacement services, depending

1 on wage levels. *PacifiCorp's Confidential Response to Staff Data Request 13*
2 *(PacifiCorp informed Staff the information in the above paragraph is not*
3 *confidential).*

4
5 **Q. How are these differences in the plans manifested in the total severance expense**
6 **the Company seeks to defer?**

7 A. The Executive Severance Plan is responsible for 36% of the total severance expense
8 of \$42 million, or an average of about \$1.66 million for each of the nine executives
9 involved. The remaining 64% of the severance expense offered in the Change-in-
10 Control Plan, averages \$117,000 for each of the 232 non-executive personnel
11 involved. *PacifiCorp Confidential Attachment to ICNU Data Request 6.4.*
12 *(PacifiCorp informed Staff the information in the above paragraph is not*
13 *confidential).*

14
15 5. *Staff's analysis of Adjustment 8.13 and the accounting petition*

16
17 **Q. What is the framework for Staff's analysis of the issues regarding recovery of**
18 **transition costs?**

19 A. There are two basic issues the Commission should resolve. Are these costs
20 recoverable from ratepayers? If not, the Commission should reject Adjustment 8.13,
21 and deny the Company's accounting petition. If so, what costs are appropriate to
22 recover through rates, and at what level?

1 a. **Should these transition costs be included in setting rates in this**
2 **case?**
3

4 **Q. Should these transition costs be recoverable from ratepayers?**

5 A. Yes. For unregulated companies, expenses such as severance expenses are period
6 costs which diminish profits in the year incurred. The avoided future wages
7 presumably increase future profits, which benefits shareholders in future years.

8 By contrast, for regulated utilities, the regulator has the opportunity to spread
9 these expenses over time, thereby smoothing earnings and sharing the expenses and
10 the benefits between shareholders and customers.

11 In this case, there are future benefits from the current PacifiCorp severance
12 program, and it is fair to spread the expense over the next few years to match the
13 benefits.

14
15 **Q. Has the Commission approved rate treatment of net severance costs or similar**
16 **costs in other cases?**

17 A. Yes. The Commission has issued accounting orders similar to the type requested by
18 PacifiCorp. For example, the Commission granted Puget Sound Energy Inc.
19 ("Puget") authority to defer and capitalize the expenses of a vegetation management
20 program, where the expenses would occur in the first few years of the program, but
21 the benefits would last for many more years.¹⁰ Similarly, the Commission granted
22 PacifiCorp authority to defer the severance expenses and other transition costs

¹⁰ *In re Petition of Puget Sound Energy, Inc.*, Docket UE-980877, Order Authorizing Accounting Treatment (July 8, 1988).

1 incurred by ScottishPower's acquisition of the Company.¹¹ In both cases, the
2 benefits of deferring and amortizing the expenses exceeded the costs.

3
4 **Q. What is the connection between the Company's accounting petition in Docket
5 UE-060817, and the Company's general rate case in Docket UE-061546?**

6 A. The test year for the general rate case ends in March 2006, and the acquisition by
7 MEHC occurred in that same month. Employees began to receive lay-off notices in
8 March 2006; a process that will continue until March 2007.

9 Therefore, the test year contains a full year of wages for those displaced
10 employees. If test year wages for departing employees are not adjusted, rates from
11 this case would reflect employee wage expense based on more employees than the
12 Company will have going forward.

13 In its Adjustment 8.13, the Company proposes to remove the going forward
14 wages of the laid-off employees, add back an amortization of the regulatory asset for
15 deferred severance expenses, and include in rate base the unamortized balance as a
16 regulatory asset.

17
18 **b. If these transition costs are recoverable in rates, what types and
19 levels of costs should be recovered in rates?**
20

21 **Q. What issues does Staff address regarding the level of recovery of these
22 transition costs?**

¹¹ *In re Petition of Pacific Power & Light, d/b/a PacifiCorp, Docket UE-000969, Order Granting Request to Defer Early Retirement and Severance Program Costs (August 30, 2000).*

1 A. There are two basic issues. First, should the Company be permitted to recover the
2 transition costs it recorded before the date it filed the petition? Second, should any
3 adjustments be made to the amount the Company is requesting to defer and
4 amortize?

5

6 **Q. Turning to the first issue, is PacifiCorp seeking to recover transition costs**
7 **recorded before it filed the petition?**

8 A. Yes. The Company filed its petition on May 19, 2006. During March and April
9 2006, 33 employees were notified of their dismissal from the Company. Six of the
10 nine laid-off executives received notice in this time frame. The date of notification is
11 referred to as the Displacement Date. This is the point in time when a company must
12 record an expense and a liability for the costs it will incur because of the termination.

13

14 **Q. Is the expense the Company recorded on the Displacement Date the final known**
15 **expense for those terminations?**

16 A. No. Most of the employees were given 60 days notice and had the opportunity to
17 find another job within the Company. If an employee were to find another job
18 within the Company, the severance liability and expense would be reversed on the
19 books. However, only a handful of employees found other employment within
20 PacifiCorp following receipt of the termination notice.

21

22 **Q. Should the Commission permit the Company to recover the transition costs**
23 **recorded before the petition was filed?**

1 A. No. The Commission has stated it will only consider for deferral expenses a utility
2 recorded after the date the utility files its request for deferral accounting.¹²

3

4 **Q. Has the Commission allowed exceptions to this policy?**

5 A. Yes. The Commission has made exceptions where events outside the utility's
6 control caused excessive expenses and the Commission determined it was fair to
7 spread the expense over time. However, the utility's petition to defer such expenses
8 must still be filed in a timely manner after the event.

9

10 **Q. Do such extraordinary circumstances exist here?**

11 A. No. The timing of this petition was well in the control of management. There is no
12 reason the Company could not have filed its petition sooner. Therefore, the
13 Commission should rule that the severance expenses PacifiCorp incurred before it
14 filed its accounting petition are not eligible for deferral or recovery through rates.
15 The Commission should exclude severance expenses for employees displaced prior
16 to May 2006. Accordingly, \$13,592,628 (total company) of transition costs should
17 be removed for this reason.

18

19 **Q. Turning to the second issue, should the Commission further adjust the amount
20 of transition costs the Company may capitalize and amortize to rates?**

21 A. Yes. Staff proposes five adjustments:

¹² *In re Petition of PacifiCorp, d/b/a Pacific Power & Light Co.*, Docket UE-020417, Third Supplemental Order Regarding Scope of Proceeding and Threshold Legal Issues (September 27, 2002) at 7-8, ¶25.

- 1) For executives with displacement dates after April 2006, the Commission should reduce the severance balance to reflect the level of benefits received by the displaced non-executive employees;
- 2) The Commission should approve deferral and recovery of severance costs for non-executive employees with a displacement date after April 2006;
- 3) The Commission should base any adjustment on updated information regarding the two plans;
- 4) The Commission should not allow PacifiCorp to recover carrying costs on transition cost balances; and
- 5) The Company should not be permitted to recover the transition costs associated with the change in fiscal year.

Q. Starting with the first adjustment, why should the Commission reduce the severance balance to reflect the level of benefits received by the displaced non-executive employees with displacement dates after April 2006?

A. Staff is concerned with the very substantial amounts granted to executives upon their departure from the Company. The Commission expressed a similar concern in a recent order: "in this era of substantially escalating executive compensation we are obligated to consider how much the ratepayers of a regulated monopoly should be required to pay."¹³

¹³ *Utilities & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket UE-060266, Order 08, Rejecting Tariff Sheets; Authorizing and Requiring Compliance Filing (January 5, 2007) at 32, ¶ 97.

1 **Q. Did PacifiCorp provide reasons why it paid executives the amounts it did for**
2 **severance pay?**

3 A. No.

4
5 **Q. How should the Commission treat executive severance payments?**

6 A. The Commission should allow executive severance payments at the same percentage
7 of pay level as non-executives received. Even at that level, the amount
8 recommended for deferral for the few executives displaced after April 2006 would
9 be over \$500,000 each.

10

11 **Q. How did you calculate a commensurate level of deferred expense for the**
12 **executives?**

13 A. The non-executives displaced after April 2006, received a severance package worth
14 about 88% of their annual wage, on average. I applied this 88% to the wages of the
15 executives. The result is a reduction in the deferral of about \$3.4 million (system-
16 wide).

17

18 **Q. Next, why should the Commission approve deferral and recovery of severance**
19 **costs for non-executive employees with a displacement date after April 2006?**

20 A. The non-executive employees who received notice of displacement after April 2006
21 are at least within the same month the Company filed its petition. Staff will take a
22 liberal stance and consider this as being within the Commission's stated time period
23 for allowing deferring an expense.

1 The forgone salaries from the dismissal of these employees will provide
2 future benefits to the Company and ratepayers. A three-year amortization of the
3 severance costs will not exceed the benefits. Staff therefore recommends the deferral
4 of the severance costs of the non-executive employees with displacement dates after
5 April 2006, as a fair treatment of these costs.

6
7 **Q. What updated information should the Commission use in making the**
8 **adjustment?**

9 A. The Company's Adjustment 8.13 is based on information available as of August 31,
10 2006. *Exhibit ___ (PMW-IT) at 22.* The Company provided data updated to
11 December 31, 2006, in its response to ICNU Data Request 6.4. This more recent
12 data is a better reflection of the forward-looking operations of the Company and it
13 should be the basis for this adjustment. This data shows the annual savings
14 associated with the annual level of loaded labor costs is \$35,881,000, and that the
15 severance costs to achieve the savings is \$42,883,000.¹⁴

16
17 **Q. Turning to the fourth issue, has the Company accrued carrying costs on**
18 **deferred transition expense balances before those transition costs are included**
19 **in rate base?**

20 A. No. However, PacifiCorp proposes to accrue a carrying charge on the deferred
21 expense prior to the time the deferred expense is included in rate base.

22

¹⁴ Exhibit ___ (TES-5) at 2, line 16.

1 **Q. Should the Commission grant the accrual of carrying costs prior to including**
2 **the deferred expense in rate base?**

3 A. No. The disposition of the deferred expense is not known until the commission
4 issues its opinion. There should be no accrual of interest on an unknown balance.
5 Also, as I explained earlier, the Commission's regulatory actions share the benefits
6 and costs between shareholders and customers, to provide a better matching and to
7 smooth earnings flow. This goal can be satisfied without accruing carrying charges
8 before the petition is granted.

9

10 **Q. Finally, why should the Commission deny the Company's request to defer the**
11 **fiscal year change expense?**

12 A. The Company's initial estimate of the cost to convert to a calendar fiscal year was
13 about \$0.5 to \$1.0 million. A more current estimate is closer to \$400,000 (total
14 company), compared to a total information technology budget of \$55 million.
15 *PacifiCorp Responses to Staff Data Requests 11 & 12.* Staff considers this an
16 immaterial level of expense for deferral. Also, this expense is not expected to occur
17 in future years.

18

19 **c. Calculation of Staff's Adjustment 8.13**

20

21 **Q. What is the overall effect of all of Staff's adjustments on the Company's**
22 **Adjustment 8.13, MEHC Transition Savings?**

1 A. Overall, the adjustment reduces Washington expenses by \$2,891,698, and increases
2 rate base by \$1,274,095, for a net reduction in revenue requirements of \$2,863,983.
3 My Exhibit ___ (TES-5) presents the calculation of the adjustment.
4

5 **Q. Please explain your Exhibit ___ (TES-5).**

6 A. The calculation on this exhibit replaces Company Adjustment 8.13 with the updated
7 information provided in the Company's Response to ICNU Data Request 6.4, and
8 then makes the four adjustments I just identified.

9 My exhibit begins with a determination of the proposed balance for deferral
10 and the associated expense. The updated system-wide severance expense of
11 \$42,883,385 is shown on page 1, line 27. Of this amount, Staff proposes to remove
12 the severance expense incurred prior to the filing of the petition, line 4, and a portion
13 of the executive severance expense, line 11. The severance expense for non-
14 executive employees proposed for recovery is on line 14.

15 This leaves a system-wide recoverable balance of \$25,893,073, line 16, of
16 which \$1,911,142 would be allocated to Washington. When amortized over three
17 years, the annual expense is \$8,631,024 system, or \$637,047 in Washington, line 19.

18 Lines 23-46 show Staff's calculation of Adjustment 8.13. The average
19 balance of the regulatory asset, less the average balance of the accumulated
20 amortization in the first year results in a rate base addition of \$1,274,095 for
21 Washington (line 35). Lines 39-40 show the removal of the test-year severance
22 expenses, and line 42 adds in Staff's amortization expense, for a net reduction in
23 Washington of \$243,366.

1 The annual savings for the avoided wages of the displaced employees is
2 shown on line 44. Because those employees are no longer employed by the
3 Company, that expense will not occur going forward. This adjustment reduces
4 Washington expenses by \$2,348,332 (line 44). The net expense reduction in
5 Washington is \$2,891,698 (line 45).

6
7 **Q. Is Staff's revenue requirement reduction of \$2.86 million comparable to the**
8 **Company's Adjustment 8.13, which reduces revenues by about \$1.2 million?**

9 A. Partly. The Company used the level of expenses that was known at the time the
10 Company filed its case. Staff used updated figures. Also, there is an error in the
11 Company's calculation. Finally, Staff's Adjustment 8.13 reflects the various other
12 adjustments I have described.

13
14 **Q. What error did the Company make?**

15 A. The figure in error is the "MEHC Transition Savings" of \$(14,102,326), shown on
16 page 8.13 of Exhibit ___ (PMW-3). On page 8.13.1, PacifiCorp correctly removes
17 the expenses for the "Change-in-Control Severance" (\$10,716,663) and the "SERP
18 Change-in-Control Severance" (\$1,211,600). However, the Company incorrectly
19 reverses the same figures in the latter part of the same page, by reducing the
20 "estimated annual savings" to \$14.1 million from \$26.0 million. The Company has
21 agreed this is an error.

1 d. **Appropriate accounting for transition costs**

2 **Q. What accounts are appropriate to use if the Commission grants the accounting**
3 **petition?**

4 A. If the Commission decides that some form of amortization of transition costs is
5 appropriate, the Commission could accept PacifiCorp's proposed accounting. The
6 Company proposes to record the deferred expense in Account 182.3, Other
7 Regulatory Assets, with amortization to Account 930.2, Miscellaneous General
8 Expenses.

9 The Company also proposes to include the unamortized balance in rate base.
10 However, the Commission should permit this only to the extent this rate base item
11 contributes to a positive investor-supplied working capital. The amortization may
12 begin in the month rates become effective in the present general rate case.

13
14 6. *Conclusions*

15
16 **Q. How should the Commission implement Staff's recommendations for transition**
17 **costs in PacifiCorp's general rate case, Docket UE-061546?**

18 A. Should the Commission accept Staff's Adjustment 8.13, Staff recommends that
19 Washington's test year expenses be reduced by removing the severance expense
20 from the results of operations, adding back one year of amortization expense, and
21 deducting the wage savings, for a net expense reduction of \$2,891,698. Finally,
22 Staff recommends \$1,274,095 be added to rate base, which represents the average

1 balance of the first year's unamortized deferral balance. *Exhibit* ___ (*TES-5*). As I
2 testified earlier, Staff's adjustment reduces revenue requirements by \$2,863,983.

3 **Q. How should the Commission implement Staff's recommendations for**
4 **PacifiCorp's accounting petition, Docket UE-060817?**

5 A. The Commission should grant the petition subject to the terms I list on pages 27-28
6 of my testimony.

7
8 **I. Adjustment 8.17, Customer Deposits**

9
10 **Q. Please explain Staff's proposed Adjustment 8.17, Customer Deposits.**

11 A. Adjustment 8.17 reduces rate base by the average amount of the deposits customers
12 paid to the Company during the test year, and treats the interest on the deposits as
13 operating expense.

14 Most electric utilities require new customers to make a deposit, to assure the
15 utility that the customer will make payment for services rendered. The utility
16 generally pays interest on the deposit at rates determined by tariff or Commission
17 rules. This interest is not recognized as an expense for ratemaking, but is recovered
18 by investors through the return on rate base. Rather than including the loan from
19 these customer deposits in the capital structure, the deposits are deducted from rate
20 base and the interest is recognized as an expense. This benefits ratepayers because
21 the interest rate on the customer deposits is less than the debt expense in the rate of
22 return.

