Exhibit No.\_\_\_(HEL-1T)

Docket UE-13\_\_\_\_

Witness: Henry E. Lay

**BEFORE THE**

**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| In the Matter of the Petition of PACIFICORP, d.b.a. Pacific Power & Light Company, For an Order Authorizing a Change in Depreciation Rates Applicable to Electric Property | )))))))) | Docket UE-13\_\_\_\_ |

**PACIFICORP**

**DIRECT TESTIMONY OF HENRY E. LAY**

**January 2013**

1. **Please state your name, business address and position with PacifiCorp d/b/a Pacific Power & Light Company (PacifiCorp or the Company).**
2. My name is Henry E. Lay. My business address is 825 N.E. Multnomah Street, Suite 1900, Portland, Oregon, 97232. I am employed by the Company as corporate controller.

**Qualifications**

1. **Please briefly describe your professional experience and educational background.**
2. I have a Bachelor of Science degree in Accounting from the University of Utah. I have worked for the Company for over 37 years, primarily in corporate accounting management roles. The areas for which I have been responsible include asset\plant accounting, corporate\general accounting, regulatory accounting, and customer accounting. In the past, I have personally prepared depreciation studies for the Company. I have also supervised the independent experts the Company has retained to conduct the current and past depreciation studies.

**Purpose of Testimony**

1. **What is the purpose of your testimony?**
2. The purpose of my testimony is as follows:
* I summarize the Company’s proposal for new depreciation rates and the effect on annual depreciation expense from applying the proposed depreciation rates to depreciable plant balances. The proposed rates are contained in the Depreciation Study based on projected December 31, 2013 balances performed on behalf of the Company by Mr. John J. Spanos of Gannett Fleming, Inc. (Depreciation Study). The Depreciation Study is provided as Exhibit No. \_\_ (JJS-3).
* I provide background information describing the development of the Depreciation Study and explain why I believe the depreciation rates resulting from the Depreciation Study are accurate and reasonable.
* I identify and discuss the significant issues considered during the preparation of the Depreciation Study. The disposition of these issues was reflected in the data provided to Mr. Spanos and, in turn, this data formed the basis for the Depreciation Study and the recommended changes in depreciation rates.
* I introduce the other Company witnesses who will testify in this proceeding and provide a brief description of the subject matter on which they are testifying.
* I briefly summarize the Company’s recommendations to the Washington Utilities and Transportation Commission (Commission or WUTC).

## Results of the Depreciation Study

**Q. Please explain the depreciation rates for which the Company is seeking Commission approval in this proceeding.**

A. The Company seeks Commission approval of the depreciation rates contained in the Depreciation Study based on December 31, 2013 projected balances performed by Mr. John J. Spanos. As shown in the Appendix of the Depreciation Study and as summarized in Mr. Spanos’ testimony, the Depreciation Study proposes a system-wide increase of 0.37 percent (or 0.70 percent including the accelerated depreciation associated with early retirement of the Carbon plant) to the current composite depreciation rate of 2.54 percent for the Company’s electric utility plant, resulting in a new composite depreciation rate of 2.91 percent (or 3.24 percent including the Carbon plant). The specific depreciation rate changes recommended for the components of the composite depreciation rate are set forth in account detail in the Appendix to the Depreciation Study.

**Q. Please explain how the depreciation rates were developed.**

1. The Company instructed Mr. Spanos to use December 31, 2011, historical data as the basis for his depreciation life study analysis, which was then used to develop depreciation rates based on projected December 31, 2013 balances. This process is further described in Mr. Spanos’ testimony.
2. **What is the effect on annual depreciation expense if the depreciation rates recommended by Mr. Spanos are adopted?**
3. The effect of applying the recommended depreciation rates to the projected December 31, 2013 depreciable plant balances is an increase in total Company annual depreciation expense of approximately $83.9 million (or $160.8 million including Carbon plant), compared with the level of annual depreciation expense developed by application of the currently authorized depreciation rates to the same plant balances. Annual depreciation expense by functional plant classification is summarized in the Appendix to the Depreciation Study.

Adoption of the depreciation rates proposed in the Depreciation Study results in an increase of approximately $0.8 million in annual Washington jurisdiction depreciation expense, based on projected December 31, 2013 depreciable plant balances. The calculation of the Washington jurisdictional amount under the west control area inter-jurisdictional allocation methodology is described in Exhibit No.\_\_ (HEL-2).

**Q. What does the Company propose as the effective date for implementing the new depreciation rates?**

A. The Company’s accounting system maintains depreciation rates on a calendar year basis. Therefore, the Company proposes that the new depreciation rates be made effective January 1, 2014, which is the beginning of the next calendar year following the anticipated approval of the study.

# Depreciation Study Background

1. **Please explain the concept of depreciation.**
2. There are many definitions of depreciation. The following definition was put forth by the American Institute of Certified Public Accountants in its Accounting Research Bulletin #43:

Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation.

The actual payment for an electric utility plant asset occurs in the period in which it is acquired through purchase or construction. Depreciation accounting spreads this cost over the useful life of the property. The fundamental reason for recording depreciation is to provide for accurate measurement of a utility’s results of operations. Capital investments in the buildings, plant, and equipment necessary to provide electric service are essentially a prepaid expense, and annual depreciation is the part of that expense applicable to each successive accounting period over the service life of the property. Annual depreciation is an important and essential factor in informing investors and others of a company’s periodic income. If it is omitted or distorted, a company’s periodic income statement is distorted and would not meet required accounting and reporting standards.

1. **Why is depreciation especially important to an electric utility?**

A. An electric utility is very capital intensive; that is, it requires a tremendous investment in generation, transmission, and distribution equipment with long lives in order to provide electric service to customers. Thus, the annual depreciation of this equipment is a major item of expense to the utility. Regulated electric prices are expected to allow the utility to fully recover its operating costs, earn a fair return on its investment and equitably distribute the cost of the assets to the customers using these facilities. If depreciation rates are established at an unreasonably low or high level for ratemaking purposes, the utility will not recover its operating costs in the appropriate period, which will shift either costs or benefits from current customers to future customers.

1. **Why was it necessary for the Company to conduct the Depreciation Study?**
2. It is sound accounting practice to periodically update depreciation rates to recognize additions to investment in plant assets and to reflect changes in asset characteristics, technology, salvage, removal costs, life span estimates, and other factors that impact depreciation rate calculations. The Company conducts depreciation studies as it deems appropriate or as mandated by the Commission. The Company’s last Depreciation Study was conducted approximately five years ago. The Company’s current depreciation rates in Washington were effective on January 1, 2008, based on a 2007 Depreciation Study.
3. **Was the Depreciation Study prepared under your direction?**
4. Yes. As corporate controller, I have responsibility for the Company’s corporate accounting departments and for ensuring compliance with Company accounting policies and procedures. This includes periodic review and study of depreciation rates.
5. **Do you believe that the estimated plant depreciable lives and depreciation rates developed in the Depreciation Study provide the Company with a fair and reasonable recovery of its investment in electric utility plant and equipment?**
6. Yes, I believe that the Depreciation Study is well supported by the underlying engineering and accounting data and that the resulting depreciation rates produce an annual depreciation expense that is fair and reasonable for both financial reporting and ratemaking purposes.
7. **What is the basis for your conclusions about the Depreciation Study?**
8. I believe that a good depreciation study is the product of sound analytical procedures applied to accurate, reliable accounting and engineering data. I have reviewed Mr. Spanos’ work in preparing the Depreciation Study and I concur with his choice and application of analytical procedures as described in his testimony. With respect to data inputs, the estimated generation plant economic lives used in the study are those provided by the Company as explained in Mr. Andrews’ testimony. Depreciable life estimates for other types of plant and equipment are based on Mr. Spanos’ actuarial analysis of the data and reviewed for reasonableness by the Company. The accounting data has also been carefully and consistently prepared. Company employees trained in depreciation techniques extracted and summarized the retirement, salvage, and removal cost data from the accounting system, and then reviewed it for completeness and accuracy before it was provided to Mr. Spanos for use in this study. Because I am comfortable with both the quality of the data inputs and the professionalism of the analysis, I recommend approval of the rates contained in the Depreciation Study.

**Significant Issues**

1. **Please summarize the significant issues you considered in your supervision of the Depreciation Study.**

A. The most significant issue considered in the current study relates to the impact of incremental capital additions on the Company’s steam generating facilities. These capital additions are the most significant factor creating the increase in depreciation expense. Further explanation of this issue is included in Mr. Andrews’ testimony.

**Q. Is this a new issue in relationship to the steam generating facilities?**

A.No, this issue was identified in the last depreciation study where the Company proposed to include projected capital additions into depreciation rates to help mitigate potential future depreciation step increases. The Commission’s adoption of depreciation rates arising out of that study did not allow any recognition of additions occurring after the implementation of those rates.

**Q. Did the Company consider extending the depreciation lives of the steam generating facilities to mitigate the increase in depreciation expense?**

A. Yes, but recognizing the regulatory and statutory uncertainty regarding the period in which steam generating facilities will be allowed to continue to operate, the Company is continuing to recommend retaining 61 years, as previously approved by the Commission, as the depreciable terminal life of steam generating facilities where the Company is not a minority owner.

**Q. What is the significant issue related to hydroelectric facilities you considered in the Depreciation Study?**

A.The prior Depreciation Study based hydroelectric plant terminal lives primarily on Federal Energy Regulatory Commission (FERC) hydroelectric plant license termination dates. For this study, the Company has continued to use the FERC hydroelectric plant license termination dates and have updated those lives where new licenses have been issued.

**Q. What are the other issues related to hydroelectric facilities you considered in this study?**

A.The prior Depreciation Study included removal cost for hydroelectric facilities where the Company has entered into negotiations or settlements to remove those facilities, as well as a decommissioning reserve for minor hydroelectric facilities that may be removed within the next ten years. The Company has updated the Depreciation Study to reflect the current projection for small plants where the Company has estimated some probability of them being decommissioned in the next ten-year period. This reserve is not intended to cover the decommissioning or removal of any large facility.

**Q. What is the significant issue related to wind generation facilities in the Depreciation Study?**

1. The Company has continued to add renewable resources to its generation portfolio, in compliance with renewable portfolio standards in Washington and other states. With the expansion of the Company’s wind generation fleet, the Company has gained more experience related to the operation and maintenance of wind generation facilities. As part of the Depreciation Study, the Company is recommending extending the terminal lives of wind generation facilities by five years. This issue is discussed further in Mr. Andrews’ testimony.
2. **What is the significant issue related to gas generation facilities in the Depreciation Study?**
3. Since the last Depreciation Study, the Company has experienced a number of required overhauls on its gas generation facilities. This information has been provided to Mr. Spanos and has been included in the Depreciation Study. This experience has resulted in a significant increase in interim retirements, which produced an increase in depreciation rates.
4. **Were there any significant changes in the Depreciation Study related to transmission and distribution plant assets?**
5. No. Mr. Spanos was provided the historical data for both transmission and distribution assets including removal costs, salvage, and third party accommodation payments related to removal cost to use in determining the proposed depreciation lives and rates. There were no significant changes outside of those which would normally result from updating the study.
6. **What is the significant issue related to general plant facilities in this study?**
7. The Company has opted to apply FERC accounting release 15 to the remainder of communication equipment not previously included. In accordance with this accounting standard, the Company will apply a 24-year life, which is the composite of the lives approved in the last study.
8. **What is the significant issue related to mining facilities in this study?**

A. Since the last study, significant changes in underground mining safety requirements coupled with additional geologic analysis have resulted in reduced levels of economically recoverable reserves at the Company’s Deer Creek mine. The Company has updated the life of the mine based on its most current information.

## Introduction of Witnesses

1. **Who will be testifying on behalf of the Company in support of the Company’s Petition?**

A. Two other witnesses will testify on behalf of the Company: Mr. John J. Spanos, Senior Vice President of Gannett Fleming, Inc. and Mr. K. Ian Andrews, manager engineering and environmental for PacifiCorp Energy.

Mr. Spanos presents the Depreciation Study and the depreciation rates for which the Company is seeking Commission approval. He describes how the Depreciation Study was prepared and discusses the basis for the recommended changes in depreciation rates.

Mr. Andrews describes the process used by Company engineers to evaluate the current approved plant depreciable lives for steam generating stations. He describes the procedure used to estimate the retirement date for the Company’s gas, wind and hydroelectric generating stations. He demonstrates that the estimated retirement dates proposed by the Company for generation plants are reasonable and prudent and are appropriate inputs for Mr. Spanos’ depreciation analysis. Mr. Andrews also explains why the rates the Company proposes to include as terminal net salvage, or “decommissioning costs,” in the calculation of depreciation rates for generating plants are reasonable and prudent.

**Summary of Recommendations**

1. **Please summarize your recommendations to the Commission.**
2. I recommend that the Commission find that the depreciation rates sponsored by Mr. Spanos in the Depreciation Study based on projected December 31, 2013 balances are fair and reasonable depreciation rates for the Company. I further recommend that the Commission order the Company to implement these depreciation rates in its accounts and records effective January 1, 2014.

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

1. Yes.