

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	
)	Docket No. UE-050482
Complainant,)	
)	Docket No. UG-050483
vs.)	
)	<i>(consolidated)</i>
AVISTA CORPORATION,)	
)	
Respondent.)	
_____)	

EXHIBIT NO. ____ (RJF-19)

**PREFILED DIRECT TESTIMONY OF VERL R. TOPHAM IN
UTAH PUBLIC SERVICE COMMISSION DOCKET NO. 90-035-06**

September 22, 2005

UP&L Exhibit No. 1

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE INVESTIGATION)
OF THE REASONABLENESS OF ALLOCATION))
AND THE RATES AND CHARGES FOR UTAH)
POWER & LIGHT COMPANY)

Docket No. 90-035-06
PREFILED DIRECT TESTIMONY
OF
VERL R. TOPHAM

May 1990

1 Q. Please state your name, business address, and
2 present position with PacifiCorp.

3 A. My name is Verl R. Topham. My business address is
4 1407 West North Temple St., Salt Lake City, Utah.
5 I am President of Utah Power & Light, a division
6 of PacifiCorp (Company). I also serve as
7 Executive Vice President of PacifiCorp Electric
8 Operations Group.

9 Q. Please outline your employment history with Utah
10 Power & Light Company.

11 A. I was elected to my present position with the
12 Company in February, 1990. I have served as
13 Executive Vice President of PacifiCorp Electric
14 Operations since May 1989. I also previously
15 served as Executive Vice President of Utah Power &
16 Light from January, 1982 to February, 1990.
17 Previously, at Utah Power & Light Company, I was
18 elected Vice President and Chief Financial Officer
19 in 1981 and, in 1985, was elected Senior Vice
20 President, Chief Financial Officer and Commercial
21 Manager. Prior to being elected Vice President
22 and Chief Financial Officer, I served as assistant
23 corporate secretary and associate general counsel.
24 Also, since 1984 I have been a member of the Board
25 of Directors of Utah Power & Light Company.

26 Q. What is your educational background?

1 A. In 1955, I received a Bachelor of Science Degree
2 in Law from the University of Utah. In 1960, I
3 received a Juris Doctorate Degree in Law from the
4 same institution.

5 Q. Have you previously testified in regulatory
6 proceedings?

7 A. Yes. I have testified before the Public Service
8 Commission of Utah (Commission), the Idaho Public
9 Utility Commission, the Wyoming Public Service
10 Commission, and the Federal Energy Regulatory
11 Commission.

12 Q. Please indicate who the Company witnesses will be
13 in this proceeding and what issues they will
14 address.

15 A. In his prefiled testimony Mr. Colby will introduce
16 the technical witnesses for the allocation issues.
17 Mr. Gregory N. Duvall will address how net power
18 costs would be calculated for use in determining
19 the Company's revenue requirement if the
20 Commission were to eliminate the Energy Balancing
21 Account (EBA). Mr. Robert R. Dalley will sponsor
22 an Exhibit reflecting results of operations
23 without the EBA [UP&L Exhibit No. 3.4 (RRD-4)]. I
24 will present the policy position of the Company
25 requesting the elimination of the Energy Balancing
26 Account.

1 Q. How is your testimony organized?

2 A. I will address the issue of why the EBA should be
3 eliminated as follows:

4 ♦ The EBA is not appropriate in the Company's
5 current operating environment.

6 ♦ The EBA impedes management's ability to
7 respond to competition.

8 ♦ The EBA impedes management's ability to
9 manage the Company.

10 ♦ Other reasons for elimination of the EBA.

11 ♦ Proposal for termination of the EBA.

12 SUMMARY

13 Q. Mr. Topham, please briefly summarize your
14 testimony.

15 A. The Company believes that the elimination of the
16 EBA is necessary for several reasons. First, the
17 EBA is not appropriate in the current operating
18 environment of the merged Company. Conditions
19 which may require a power cost adjustment (PCA)
20 clause such as extreme volatility of fuel costs
21 are not currently applicable to the Company. The
22 EBA was established to address the problems of an
23 operating environment which do not exist in the
24 current environment. Regulatory oversight of
25 power costs is not diminished without the EBA. It
26 is also of interest to note that regulatory

1 Commissions in Arizona, Oregon, Washington, and
2 Montana have recently terminated or denied PCA's
3 for electric utilities subject to their
4 jurisdiction.

5 Second, the EBA impedes the ability of
6 management to respond appropriately to
7 competition. The Company response to competition
8 is overall stable prices. The EBA makes this
9 policy impossible to implement because it creates
10 price instability.

11 Third, the EBA impedes management's ability
12 to manage the Company. The EBA impact of
13 potential transactions may render an otherwise
14 beneficial transaction unacceptable. The EBA
15 requires full pass-through of Utah jurisdictional
16 fuel-related net power costs. This impedes the
17 ability of the Company to maintain stable prices
18 by offsetting unavoidable increases in power costs
19 with decreases or cost deferrals in non-power cost
20 areas. The elimination of the EBA provides
21 maximum incentive for management while providing a
22 guaranteed level of performance for customers.

23 Other reasons for elimination of the EBA
24 include, the unintended phenomenon that benefits
25 or penalizes customers as actual retail loads
26 fluctuate from test period loads. Additionally,

1 the EBA raises questions about retroactive rate
2 making.

3 The Company therefore proposes to set prices
4 in the second phase of this case without the
5 impact of the EBA. The Company proposes to
6 terminate the EBA collection rate when prices
7 determined in Phase II of this proceeding become
8 effective by transferring Schedule 35 to general
9 rate schedules. The Company proposes that if a
10 payable balance in the EBA exists on that date, it
11 would be returned to customers in a single lump
12 sum distribution. Alternatively, the Company
13 proposes that if a receivable balance exists on
14 that date it would be held as a regulatory asset,
15 to be dealt with in an appropriate future
16 proceeding before this Commission.

17 THE EBA IS NOT APPROPRIATE TO

18 THE COMPANY'S CURRENT OPERATING ENVIRONMENT

19 Q. Mr. Topham, under what conditions may a PCA be
20 appropriate?

21 A. The decision to establish a PCA is a complex issue
22 specific to a particular company. However, I
23 believe the overriding circumstance under which
24 such a mechanism may be appropriate is extreme
25 volatility of power costs over a short period of
26 time.

1 Q. Do you believe that the current conditions warrant
2 a PCA for the Company?

3 A. No. I believe that a PCA is not appropriate to
4 the current operating environment of the Company.

5 Q. Please explain.

6 A. In the late 1970's and early 1980's certain
7 economic conditions prevailed which severely
8 impacted power markets. For example, the oil
9 embargo coupled with relatively heavy reliance on
10 oil fired generation, as well as double digit
11 inflation significantly impacted power costs.
12 These conditions made forecasting fuel-related net
13 power costs difficult for rate making purposes and
14 contributed toward the Commission decision to
15 establish the EBA in 1979 (See Order in case
16 No.78-035-21, 79-035-03, pp 14 - 17, dated July
17 20, 1979). By contrast recent years have
18 reflected moderate inflation, and oil prices have
19 generally stabilized. It is therefore not
20 surprising that this stabilized economic
21 environment has resulted in less volatile power
22 costs. The conditions that created the extreme
23 volatility of power costs do not exist in the
24 current economic environment. Therefore, the EBA
25 is not appropriate under such economic conditions.

26 Q. Are you saying that power cost volatility has been

1 eliminated in the current operating environment?

2 A. No. Certain power costs, by their nature are
3 subject to weather and water conditions and other
4 factors that are outside the control of
5 management. Therefore they will always reflect a
6 certain degree of volatility. However, the
7 extreme volatility of power costs which previously
8 prevailed has stabilized. This stability has
9 resulted from changed economic conditions and
10 through aggressive management of Company costs.

11 Q. Will regulatory oversight of power costs be
12 diminished in the absence of the EBA?

13 A. No. In the absence of the EBA regulatory
14 oversight of power costs will be accomplished
15 principally through the Semi-Annual Results of
16 Operations reports. These reports are intended to
17 provide a detailed basis for the monitoring of
18 Results of Operations between general rate cases.
19 I anticipate that regulators will focus their
20 attention on these reports as a mechanism to
21 monitor overall Company performance. The
22 regulatory oversight of power costs or any other
23 component of results of operations should not be
24 diminished in the least by the elimination of the
25 EBA.

26 Q. What is the recent experience of other western

1 regulatory agencies relative to PCA's?

2 A. For the information of the Commission, I believe
3 it is worthy of note that electric utilities in
4 Arizona, Montana, Oregon, and Washington have
5 recently been denied or ordered to terminate
6 PCA's. Additionally, no electric utility in
7 Wyoming, Montana, Oregon, or Washington currently
8 operates under the terms of a PCA mechanism.

9 Q. Prior to the merger with Utah Power, what was the
10 experience of PacifiCorp regarding the treatment
11 of power costs in the rate making process?

12 A. Pacific Power & Light jurisdictions, both prior
13 and subsequent to the merger establish normalized
14 power costs for rate making purposes by use of the
15 production cost model. This model has been used
16 for this purpose for over a decade without
17 substantial controversy. Mr. Gregory Duvall
18 explains the production cost model and related
19 theory in his prefiled testimony. Additionally,
20 it should be noted that while other utilities in
21 jurisdictions served by Pacific Power operated
22 under PCA mechanisms, either voluntarily or
23 otherwise, no such mechanism was ever requested by
24 or imposed on Pacific.

25 Q. Do you have other grounds on which to base your
26 believe that the EBA is not appropriate in the

1 current operating environment of the Company?

2 A. I think it is important to keep in mind that the
3 power supply system for which the EBA was
4 established in 1979 no longer exists. The nature
5 of the merged Company and its operating
6 environment are not similar to the all thermal-
7 based system of 1979. It therefore seems
8 inappropriate to continue to regulate and operate
9 the Company based on a mechanism that was designed
10 to address issues existing in 1979. I believe
11 that if the Company was not presently operating
12 under the terms of the EBA, the current conditions
13 and operating environment would not require that
14 such a clause be imposed on the Company.

15 THE EBA IMPEDES MANAGEMENT'S ABILITY

16 TO RESPOND TO COMPETITION

17 Q. Mr. Topham, please explain the impact of
18 competition on the Company.

19 A. the Company operates in an environment of ever-
20 increasing competition from independent power
21 producers, public power organizations, self-
22 generators, other investor-owned utilities, as
23 well as alternative energy sources such as natural
24 gas, solar energy and emerging technologies. Many
25 electric customers have more energy options today
26 than ever before. To the extent that customers,

1 particularly large customers, choose an
2 alternative to Company-supplied electric energy,
3 the Company and remaining customers are negatively
4 impacted. Therefore, it is imperative that the
5 Company be able to respond to competitive forces
6 in a proactive and positive manner.

7 Q. What is the Company's response to competition?

8 A. The Company response to competition is a
9 commitment to stable prices. Price stability
10 implies no rapid price swings in either direction.
11 The Company believes that price is a major factor
12 in competitive markets, and has been pursuing
13 strategies to maintain and/or reduce its prices
14 for several years. These efforts demonstrate Utah
15 Power's continuing intention to compete
16 successfully. At the same time, the Company
17 believes that its policy of overall price
18 stability is in the best interest of our customers
19 and shareholders. It will help us compete more
20 effectively with other energy suppliers, and will
21 provide customers some predictability about the
22 price they will pay for electric service. It will
23 also allow customers to effectively and
24 efficiently make energy investment decisions for
25 both the acquisition of equipment and the use of
26 energy. We clearly understand that we must

1 provide customers good service at competitive and
2 stable prices if we are to continue to be their
3 energy services company. Price instability simply
4 cannot be tolerated if the Company is to remain
5 competitive in the current operating environment.
6 Often predictability may be as important to a
7 customer as the absolute price, at least within a
8 reasonable band.

9 Q. How does the EBA limit the ability of the Company
10 to compete?

11 A. Price adjustments, when they occur should be tied
12 to a deliberate pricing policy aimed at efficient
13 resource use and response to given market
14 conditions. The EBA is a regulatory mechanism
15 which, by the nature of its operation, creates
16 price instability divorced from pricing policy
17 decisions. The EBA, as any balancing account,
18 creates price fluctuations every time the
19 associated surcharge (Schedule 35) is adjusted.
20 This instability is contrary to the Company
21 commitment to overall price stability and thereby
22 inhibits the Company's ability to respond to
23 competition.

24 Q. Since March, 1988, changes to the EBA collection
25 rate have resulted in substantial price
26 reductions. Are these price reductions consistent

1 with the Company's response to competition?

2 A. The Company welcomes any opportunity to
3 appropriately reduce customer prices. However,
4 price reductions as a result of EBA collection
5 rate changes are not consistent with the Company's
6 response to competition.

7 Q. Please explain.

8 A. EBA collection rate changes are essentially
9 outside the control of the Company. For example,
10 if the balance in the EBA reflects an amount
11 payable to customers, a collection rate must be
12 implemented at a value less than anticipated fuel-
13 related net power cost so that the balance payable
14 can be eliminated. The reversal of that
15 collection rate reduction when the payable balance
16 is eliminated represents an effective price
17 increase to customers. This price shifting is a
18 confusing and inappropriate price signal to
19 customers, and makes it difficult for the
20 Company's management to manage its prices in light
21 of our commitment to overall price stability.
22 Additionally, the price shifts ignore efforts to
23 correct pricing problems between classes of
24 service and runs counter to efficient pricing
25 policy. Therefore, EBA collection rate changes
26 are not consistent with the Company's response to

1 competition.

2 Q. How does the Company's commitment to overall price
3 stability relate to commitments made by the
4 Company relative to the merger of Utah Power and
5 PacifiCorp.

6 A. The Company has committed to honor promises of
7 price reductions made in conjunction with the
8 merger. Beyond that, our commitment to stable
9 overall prices does not and cannot reflect a
10 specific promise. Rather, it reflects
11 management's recognition that competitive forces
12 require a proactive and positive response. The
13 Company's response to competition is a commitment
14 to maintain customer prices as stable as economic,
15 environmental, or other conditions outside of
16 management's control will allow.

17 Q. The EBA is a mechanism which places the risk of
18 fluctuating power costs on the customer. If the
19 EBA were terminated, the risks of fluctuating
20 power costs would be placed on the Company. Why
21 is the Company willing to accept this risk?

22 A. The Company is willing to accept this risk because
23 we believe the risk is manageable. The Company
24 believes in placing the risk of management
25 practices on those that make the business
26 decisions - management - not customers.

1 Additionally, the best long-term response to the
2 threat of competition is competitive and stable
3 prices. The EBA prevents the Company from fully
4 implementing this strategy in the Utah
5 jurisdiction. We simply believe that the risks to
6 the shareholders and customers of an ineffective
7 response to competition poses a far greater threat
8 than the risk of fluctuating power costs.

9 EBA IMPEDES MANAGEMENT'S ABILITY TO

10 MANAGE THE COMPANY

11 Q. Mr. Topham, how does the EBA impact the management
12 of the Company?

13 A. Due in part to competition, the electric business
14 is more dynamic today than ever before. As new or
15 innovative types of transactions are proposed,
16 their impact on the EBA must be considered.
17 Additionally, any new or modified venture must
18 always be viewed in terms of the related EBA
19 treatment. If the EBA continues in its present
20 form, future transactions will likely be evaluated
21 based, at least in part, on their impact on the
22 EBA.

23 Q. What is the harm in evaluating the EBA impact of
24 potential transactions?

25 A. The harm is that the result of such evaluation may
26 require the Company to reject an opportunity,

1 otherwise beneficial to customers and
2 shareholders, simply because of the related EBA
3 impact. The economics of a proposed transaction
4 should stand on their own. Decisions concerning
5 proposed transactions should be based on economics
6 alone, independent of the impact of the EBA.

7 Q. Do you have an example of such a transaction?

8 A. I will propose for you this scenario. The Company
9 may be in a position to consummate an arrangement
10 on acquiring an interest in generation facilities.
11 Such a transaction could provide long-term
12 benefits to customers and shareholders. In the
13 absence of the EBA, the Company could make off
14 system sales from the generation of this facility,
15 and use the margin from those sales to support the
16 Company's investment until such time as the
17 facility was included in rate base. However, the
18 EBA passes the Utah jurisdictional portion of
19 secondary sales margin entirely and immediately to
20 Utah customers through the EBA. The Company may
21 therefore be left with limited means to offset the
22 cost of its investment until it is included in
23 rate base. Therefore, a transaction which makes
24 sense economically, and which would provide long-
25 term benefits to the Company's Utah jurisdictional
26 customers, may be declined because of EBA

1 considerations.

2 Q. Does the EBA impact Company management in other
3 ways?

4 A. Yes. Tracking of any single cost item in a
5 balancing account reduces management's ability to
6 manage its overall business to achieve the goal of
7 stable prices. Under the Company's proposal, in
8 the absence of the EBA, management would have the
9 flexibility to defer or reduce costs in one area
10 (labor or maintenance for example), in order to
11 offset unavoidable increases in another area
12 (power costs for example). The Company, thereby,
13 has the ability to hold prices stable even in
14 periods of increasing power costs. Under current
15 regulatory practices the EBA would require
16 increased power costs to be reflected in prices
17 through EBA collection rate increases. To
18 accomplish its objective of stable prices the
19 Company would be required to match each EBA price
20 increase with an offsetting general price
21 decrease. Such a scenario impedes the ability of
22 the management to manage its business, and may
23 further complicate the regulatory process.

24 Q. In the absence of the EBA, what are the
25 implications on the incentive for management
26 efficiency?

1 A. With or without the EBA, management remains
2 committed to efficient operations. This
3 commitment is demonstrated in part by efficiencies
4 implemented at the Utah Power & Light coal mines
5 which have caused coal costs to drop significantly
6 since 1985. However, I believe that by
7 elimination of the EBA, management is afforded
8 maximum incentive for efficiency because the
9 Company could be rewarded with some of the
10 benefits of power cost efficiencies between
11 general rate cases.

12 Q. In the absence of the EBA, how will customers
13 benefit from power cost efficiencies?

14 A. Customers will benefit through overall stable
15 prices. Such prices will send proper and
16 consistent pricing signals to customers and at the
17 same time allow customers to make energy
18 investment decisions based on predictable prices
19 which will not fluctuate with the operation of the
20 EBA. Prices will be based on power costs which
21 guarantee retail customers a certain level of
22 power cost efficiencies whether those efficiencies
23 are achieved or not.

24 OTHER REASONS FOR ELIMINATION OF THE EBA

25 Q. Does the EBA impact the Company when actual retail
26 loads fluctuate from test period loads upon which

1 prices were set?

2 A. Yes. The impact is based on the premise that the
3 Company's energy resources are fixed, and that as
4 retail loads fluctuate from test period loads,
5 more or less of the Company's energy resources are
6 available to make secondary sales.

7 Q. What is the impact on the Company when test period
8 retail loads exceed actual loads?

9 A. The first impact is the obvious penalty of retail
10 revenue loss resulting from actual load being less
11 than the test period loads. In the absence of the
12 EBA, this revenue loss could be at least partially
13 offset by the additional secondary sales made with
14 the resources not used to serve the retail load.
15 However, the EBA requires that all revenue from
16 secondary sales offset fuel-related net power cost
17 in the calculation of the EBA. Therefore, under
18 current regulatory practices the Company is
19 penalized a second time as a result of this
20 additional offset to the fuel-related net power
21 cost. This situation was simply not contemplated
22 at the inception of the EBA.

23 Q. What is the impact on the Company when actual
24 retail loads exceed test period loads?

25 A. The benefit to the Company is symmetrical to the
26 penalties of a retail load under-run. When retail

1 ✓ loads exceed test period loads there is an
2 increase in retail revenues related to the higher
3 retail load. This higher retail load is reflected
4 by lower secondary sales and related revenue.
5 This creates a second benefit to the Company
6 because secondary revenues offset fuel-related net
7 power costs in the calculation of the EBA.

8 Q. What is the conclusion that you draw from this
9 phenomenon?

10 A. The conclusion is that when retail loads are less
11 than test period figures the Company suffers a
12 double penalty. Conversely, when the retail loads
13 are more than test period data the Company
14 receives a benefit greater than the retail load
15 over-run. The EBA was established to mitigate the
16 impact on the ratemaking process of forecasting
17 fuel-related net power costs in a volatile power
18 market. Yet ironically, the EBA mechanism creates
19 ✓ a phenomenon of benefit or penalty to the Company
20 as retail loads fluctuate from test period levels.
21 I believe the EBA should be terminated to
22 eliminate this situation.

23 Q. Are there retroactive ratemaking questions raised
24 by the EBA?

25 A. Yes. The application of the rule against
26 retroactive ratemaking has been raised previously

1 before this Commission. In 1986 the Utah Supreme
2 Court disallowed a retroactive adjustment made to
3 the EBA in 1982 based on the rule against
4 retroactive ratemaking. From time to time other
5 retroactive adjustments have been made to the EBA
6 by way of Stipulation and/or Commission Order.
7 None of these adjustments have been contested in
8 the courts. It is not my intention here to draw a
9 legal conclusion or to claim that such adjustments
10 violate the rule against retroactive ratemaking.
11 My purpose is to simply point out that if the EBA
12 is not terminated, the issue of the legality of
13 future adjustments to the EBA may require
14 resolution.

15 Q. Does the issue of retroactive adjustments to the
16 EBA present other problems for the Company?

17 A. Yes. The earnings impact of retroactive EBA
18 adjustments is quite troublesome to the Company.
19 Retroactive adjustments to the EBA have a direct
20 impact on the current earnings of the Company. As
21 long as the EBA is subject to retroactive
22 adjustment, Company earnings must be considered
23 somewhat uncertain for management purposes. This
24 is a situation which certainly creates management
25 uncertainty relative to the EBA and may lead to
26 some uncertainty for users of the financial

1 statements.

2 PROPOSAL FOR ELIMINATION OF EBA

3 Q. Mr. Topham, how does the Company propose to
4 accomplish the termination of the EBA?

5 A. The first step in that process would be to file a
6 revenue requirement in the second phase of this
7 proceeding without the impact of the Energy
8 Balancing Account. Simultaneously with the time
9 prices from the second phase of this proceeding
10 becoming effective, the current schedule 35 EBA
11 collection rate would be terminated. The EBA
12 collection rate would be rolled in with general
13 tariffs that are produced from Phase II of this
14 proceeding.

15 Q. What about the balance that exists in the EBA at
16 that time?

17 A. Any balance payable to customers would be paid out
18 in a one-time distribution in a manner similar to
19 that proposed by the stipulation dated March 14,
20 1990 and approved by the Commission April 4, 1990
21 (Docket No. 90-035-03). Conversely, the Company
22 would request that the Commission order that any
23 balance receivable from customers, on the date of
24 EBA termination, be established as a regulatory
25 asset to be dealt with in an appropriate
26 proceeding before the Commission.

1 Q. Mr. Topham, does this conclude your pre-filed

2 testimony?

3 A. Yes, it does.

4