

Exhibit No.__(HEL-1T)
Docket UE-13____
Witness: Henry E. Lay

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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

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Docket UE-13____

**PACIFICORP
DIRECT TESTIMONY OF HENRY E. LAY**

January 2013

1 **Q. Please state your name, business address and position with PacifiCorp d/b/a**
2 **Pacific Power & Light Company (PacifiCorp or the Company).**

3 A. My name is Henry E. Lay. My business address is 825 N.E. Multnomah Street, Suite
4 1900, Portland, Oregon, 97232. I am employed by the Company as corporate
5 controller.

6 **Qualifications**

7 **Q. Please briefly describe your professional experience and educational**
8 **background.**

9 A. I have a Bachelor of Science degree in Accounting from the University of Utah. I
10 have worked for the Company for over 37 years, primarily in corporate accounting
11 management roles. The areas for which I have been responsible include asset\plant
12 accounting, corporate\general accounting, regulatory accounting, and customer
13 accounting. In the past, I have personally prepared depreciation studies for the
14 Company. I have also supervised the independent experts the Company has retained
15 to conduct the current and past depreciation studies.

16 **Purpose of Testimony**

17 **Q. What is the purpose of your testimony?**

18 A. The purpose of my testimony is as follows:

- 19 • I summarize the Company's proposal for new depreciation rates and the effect on
20 annual depreciation expense from applying the proposed depreciation rates to
21 depreciable plant balances. The proposed rates are contained in the Depreciation
22 Study based on projected December 31, 2013 balances performed on behalf of the

1 Company by Mr. John J. Spanos of Gannett Fleming, Inc. (Depreciation Study).

2 The Depreciation Study is provided as Exhibit No. __ (JJS-3).

- 3 • I provide background information describing the development of the Depreciation
4 Study and explain why I believe the depreciation rates resulting from the
5 Depreciation Study are accurate and reasonable.
- 6 • I identify and discuss the significant issues considered during the preparation of
7 the Depreciation Study. The disposition of these issues was reflected in the data
8 provided to Mr. Spanos and, in turn, this data formed the basis for the
9 Depreciation Study and the recommended changes in depreciation rates.
- 10 • I introduce the other Company witnesses who will testify in this proceeding and
11 provide a brief description of the subject matter on which they are testifying.
- 12 • I briefly summarize the Company's recommendations to the Washington Utilities
13 and Transportation Commission (Commission or WUTC).

14 **Results of the Depreciation Study**

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

17 A. The Company seeks Commission approval of the depreciation rates contained in the
18 Depreciation Study based on December 31, 2013 projected balances performed by
19 Mr. John J. Spanos. As shown in the Appendix of the Depreciation Study and as
20 summarized in Mr. Spanos' testimony, the Depreciation Study proposes a system-
21 wide increase of 0.37 percent (or 0.70 percent including the accelerated depreciation
22 associated with early retirement of the Carbon plant) to the current composite
23 depreciation rate of 2.54 percent for the Company's electric utility plant, resulting in

1 a new composite depreciation rate of 2.91 percent (or 3.24 percent including the
2 Carbon plant). The specific depreciation rate changes recommended for the
3 components of the composite depreciation rate are set forth in account detail in the
4 Appendix to the Depreciation Study.

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

6 **A.** The Company instructed Mr. Spanos to use December 31, 2011, historical data as the
7 basis for his depreciation life study analysis, which was then used to develop
8 depreciation rates based on projected December 31, 2013 balances. This process is
9 further described in Mr. Spanos' testimony.

10 **Q. What is the effect on annual depreciation expense if the depreciation rates**
11 **recommended by Mr. Spanos are adopted?**

12 **A.** The effect of applying the recommended depreciation rates to the projected
13 December 31, 2013 depreciable plant balances is an increase in total Company annual
14 depreciation expense of approximately \$83.9 million (or \$160.8 million including
15 Carbon plant), compared with the level of annual depreciation expense developed by
16 application of the currently authorized depreciation rates to the same plant balances.
17 Annual depreciation expense by functional plant classification is summarized in the
18 Appendix to the Depreciation Study.

19 Adoption of the depreciation rates proposed in the Depreciation Study results
20 in an increase of approximately \$0.8 million in annual Washington jurisdiction
21 depreciation expense, based on projected December 31, 2013 depreciable plant
22 balances. The calculation of the Washington jurisdictional amount under the west

1 control area inter-jurisdictional allocation methodology is described in Exhibit
2 No. __ (HEL-2).

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

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

9 Depreciation Study Background

10 **Q. Please explain the concept of depreciation.**

11 A. There are many definitions of depreciation. The following definition was put forth
12 by the American Institute of Certified Public Accountants in its Accounting Research
13 Bulletin #43:

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

19
20 The actual payment for an electric utility plant asset occurs in the period in
21 which it is acquired through purchase or construction. Depreciation accounting
22 spreads this cost over the useful life of the property. The fundamental reason for
23 recording depreciation is to provide for accurate measurement of a utility's results of
24 operations. Capital investments in the buildings, plant, and equipment necessary to
25 provide electric service are essentially a prepaid expense, and annual depreciation is
26 the part of that expense applicable to each successive accounting period over the

1 service life of the property. Annual depreciation is an important and essential factor
2 in informing investors and others of a company's periodic income. If it is omitted or
3 distorted, a company's periodic income statement is distorted and would not meet
4 required accounting and reporting standards.

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

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

16 **Q. Why was it necessary for the Company to conduct the Depreciation Study?**

17 A. It is sound accounting practice to periodically update depreciation rates to recognize
18 additions to investment in plant assets and to reflect changes in asset characteristics,
19 technology, salvage, removal costs, life span estimates, and other factors that impact
20 depreciation rate calculations. The Company conducts depreciation studies as it
21 deems appropriate or as mandated by the Commission. The Company's last
22 Depreciation Study was conducted approximately five years ago. The Company's

1 current depreciation rates in Washington were effective on January 1, 2008, based on
2 a 2007 Depreciation Study.

3 **Q. Was the Depreciation Study prepared under your direction?**

4 A. Yes. As corporate controller, I have responsibility for the Company's corporate
5 accounting departments and for ensuring compliance with Company accounting
6 policies and procedures. This includes periodic review and study of depreciation
7 rates.

8 **Q. Do you believe that the estimated plant depreciable lives and depreciation rates
9 developed in the Depreciation Study provide the Company with a fair and
10 reasonable recovery of its investment in electric utility plant and equipment?**

11 A. Yes, I believe that the Depreciation Study is well supported by the underlying
12 engineering and accounting data and that the resulting depreciation rates produce an
13 annual depreciation expense that is fair and reasonable for both financial reporting
14 and ratemaking purposes.

15 **Q. What is the basis for your conclusions about the Depreciation Study?**

16 A. I believe that a good depreciation study is the product of sound analytical procedures
17 applied to accurate, reliable accounting and engineering data. I have reviewed Mr.
18 Spanos' work in preparing the Depreciation Study and I concur with his choice and
19 application of analytical procedures as described in his testimony. With respect to
20 data inputs, the estimated generation plant economic lives used in the study are those
21 provided by the Company as explained in Mr. Andrews' testimony. Depreciable life
22 estimates for other types of plant and equipment are based on Mr. Spanos' actuarial
23 analysis of the data and reviewed for reasonableness by the Company. The

1 accounting data has also been carefully and consistently prepared. Company
2 employees trained in depreciation techniques extracted and summarized the
3 retirement, salvage, and removal cost data from the accounting system, and then
4 reviewed it for completeness and accuracy before it was provided to Mr. Spanos for
5 use in this study. Because I am comfortable with both the quality of the data inputs
6 and the professionalism of the analysis, I recommend approval of the rates contained
7 in the Depreciation Study.

8 **Significant Issues**

9 **Q. Please summarize the significant issues you considered in your supervision of the**
10 **Depreciation Study.**

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

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

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

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

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

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

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

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

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

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

1 A. The Company has continued to add renewable resources to its generation portfolio, in
2 compliance with renewable portfolio standards in Washington and other states. With
3 the expansion of the Company's wind generation fleet, the Company has gained more
4 experience related to the operation and maintenance of wind generation facilities. As
5 part of the Depreciation Study, the Company is recommending extending the terminal
6 lives of wind generation facilities by five years. This issue is discussed further in Mr.
7 Andrews' testimony.

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

10 A. Since the last Depreciation Study, the Company has experienced a number of
11 required overhauls on its gas generation facilities. This information has been
12 provided to Mr. Spanos and has been included in the Depreciation Study. This
13 experience has resulted in a significant increase in interim retirements, which
14 produced an increase in depreciation rates.

15 **Q. Were there any significant changes in the Depreciation Study related to**
16 **transmission and distribution plant assets?**

17 A. No. Mr. Spanos was provided the historical data for both transmission and
18 distribution assets including removal costs, salvage, and third party accommodation
19 payments related to removal cost to use in determining the proposed depreciation
20 lives and rates. There were no significant changes outside of those which would
21 normally result from updating the study.

22 **Q. What is the significant issue related to general plant facilities in this study?**

23 A. The Company has opted to apply FERC accounting release 15 to the remainder of

1 communication equipment not previously included. In accordance with this
2 accounting standard, the Company will apply a 24-year life, which is the composite
3 of the lives approved in the last study.

4 **Q. What is the significant issue related to mining facilities in this study?**

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

9 **Introduction of Witnesses**

10 **Q. Who will be testifying on behalf of the Company in support of the Company's**
11 **Petition?**

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

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

19 Mr. Andrews describes the process used by Company engineers to evaluate
20 the current approved plant depreciable lives for steam generating stations. He
21 describes the procedure used to estimate the retirement date for the Company's gas,
22 wind and hydroelectric generating stations. He demonstrates that the estimated
23 retirement dates proposed by the Company for generation plants are reasonable and

1 prudent and are appropriate inputs for Mr. Spanos' depreciation analysis. Mr.
2 Andrews also explains why the rates the Company proposes to include as terminal net
3 salvage, or "decommissioning costs," in the calculation of depreciation rates for
4 generating plants are reasonable and prudent.

5 **Summary of Recommendations**

6 **Q. Please summarize your recommendations to the Commission.**

7 A. I recommend that the Commission find that the depreciation rates sponsored by Mr.
8 Spanos in the Depreciation Study based on projected December 31, 2013 balances are
9 fair and reasonable depreciation rates for the Company. I further recommend that the
10 Commission order the Company to implement these depreciation rates in its accounts
11 and records effective January 1, 2014.

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

13 A. Yes.