Docket No. UE-001878
PacifiCorp Exhibit T-___, PJC-T1
Witness: Craven

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

| | |
|---|---|
| In the Matter of the Joint Application of PACIFICORP and PACIFICORP, WASHINGTON, INC. for an Order Approving (1) the Transfer of Distribution Property from PacifiCorp to an Affiliate, PacifiCorp, Washington, Inc., (2) the Transfer by PacifiCorp of Certain Utility Property to an Affiliate, the Service Company, and (3) the Proposed Accounting Treatment for Regulatory Assets and Liabilities, and an Order Granting an Exemption under RCW 80.08.047 for the Issuance or Assumption of Securities and Encumbrance of Assets by PacifiCorp, Washington, Inc. and/or PacifiCorp | Docket No. UE-001878 |

PACIFICORP

# SUPPLEMENTAL DIRECT TESTIMONY OF PETE J. CRAVEN

June 2001

Q. Please state your name.

A. My name is Pete J. Craven.

Q. Have you previously filed direct testimony in this proceeding?

A. Yes. I filed direct testimony in May. Additionally, I am adopting the direct testimony of C. Alex Miller that was filed in December of 2001.

**Purpose of Testimony**

Q. What is the purpose of your supplemental direct testimony?

A. The purpose of this testimony is to present the Company's proposed service company contract (the "Contract"), which is attached as Exhibit PJC-3.

Q. Please identify Exhibit PJC-3.

A. Exhibit PJC-3 is the proposed Contract that will be entered into between the newly formed service company (the "Service Company") and each of the entities to which the Service Company will be providing shared services after the proposed restructuring (collectively, the "Companies").

Q. Why is the Contract required?

A. As I indicated in my direct testimony, under the current structure, the existing PacifiCorp performs a number of common functions which support its six-state distribution, transmission and generation operations. The costs of these joint services are currently allocated for ratemaking purposes among our six jurisdictions based upon established allocation factors. Under the proposed restructuring, a single entity is needed to continue to provide these services on behalf of all of the Companies because it would be highly inefficient to require each of the Companies to develop separate capabilities. The purpose of the Contract is to describe what services the Service Company will provide and how the costs of these services, including a reasonable rate of return on investment, will be allocated among the Companies.

**Description of Contract**

Q. Please describe how the Contract is structured.

A. Section I of the Contract makes reference to Contract Exhibit I, in which all of the services available from the Service Company are listed and described. It states that, from time to time, additional services may be added to the list by the Service Company.

Section II of the Contract provides that prior to each fiscal year, each of the companies receiving services under the Contract will elect which of the available services they wish to receive during the coming fiscal year. Contract Exhibit II will reflect which services have been selected.

Section III of the Contract provides that the Service Company may provide services by utilizing the expertise of its own employees, such as executives, engineers, field personnel, geologists, attorneys, accountants, financial advisors, and other persons that have the necessary qualifications to perform the required services, or by retaining outside experts, consultants or attorneys, as needed.

Section IV of the Contract establishes the basic principles for pricing services under the Contract. Those principles, as applied to the Companies are:

a) services are to be provided at cost, including a reasonable return on capital and b) direct charges will be made for services (as opposed to allocating costs), to the extent practicable. Section IV also makes reference to Contract Exhibit III which describes cost allocation methodologies applicable to the Companies.

Section V of the Contract affirms that each recipient of services may modify its selection of services during a fiscal year by providing the Service Company with 30 days advance written notice. It also provides that the participation of any party to the Contract may be terminated upon 120 days advance written notice. Section V also provides that the Contract will be modified at any time to conform to the provisions of the Public Utility Holding Company Act or any rules, regulations or orders issued thereunder by the Securities and Exchange Commission. It also provides that no other amendments to the Contract can be made without the written agreement of all parties.

The balance of the Contract consists of typical "boiler plate" provisions.

**Description of Contract Exhibits**

Q. Please describe what is shown on Contract Exhibit I.

A. As I indicated previously, Contract Exhibit I is a list of all services that are available from the Service Company. The list is divided between "Administrative Departments" that provide administrative services that are likely going to be required by all of the Companies and "Infrastructure

Departments" that, generally speaking, provide services that are likely only to be required by the state electric companies.

Q. Please describe the cost accounting and allocation methodologies set forth in Contract Exhibit III.

A. Contract Exhibit III summarizes the methodologies that will be used to record the Service Company's costs and how they will be charged to those Companies requesting services. It reaffirms the principle that Service Company costs will be directly charged to recipients of services to the maximum extent practicable.

All Service Company costs will first be assigned to either a direct or a group cost center within an "Administrative" or "Infrastructure" department. A "Direct" cost center incurs expenditures that can be charged to an individual service recipient and a "Group" cost center incurs expenditures that must be allocated among more than one service recipient.

Contract Exhibit III specifies allocation rules for Group costs centers. In the first instance, Administrative departments will receive allocation loads from other Administrative departments (the "First Tier Allocation"). Then, under the "Second Tier Allocation", fully loaded Administrative departments are allocated to Infrastructure departments. Fully loaded Group cost centers are then allocated to the service recipients in accordance with factors defined in Exhibit III.

Q. Please provide an example of how this two-tiered allocation system would work.

A. Consider, for example, building rental expense incurred by the Service Company. In the First Tier Allocation, some portion of that expense would be allocated to the Human Resources Department of the Service Company. In the Second Tier Allocation, the Human Resources Department would allocate all of its costs (including its allocated share of rental expense) to the costs centers that it supports, for example, the Customer Service department. Total costs of the Customer Service department then would be allocated to the Companies using the allocation formulae defined in Exhibit III of the Contract. Through this two-tier allocation process, it is intended that all Service Company incurred expenditures are charged out to each of the entities to which it is providing shared services.

Q. What allocation factors will be used in the cost allocation process?

A. These are also listed in Contract Exhibit III.

Q. Please provide some examples of these allocation factors.

A. Costs of some services used by all of service recipients (such as Executive and CEO) are to be allocated using the "Company Formula", which is based upon a service recipient's relative proportion of total operating expense (excluding purchased power, fuel and wheeling expense). Where possible, costs of other services are allocated based upon formulae that more precisely reflect factors giving rise to cost incurrence. For example, human resource and employee benefit costs will be allocated based upon the relative magnitude of a service recipient's payroll and headcount.

Q. How were the proposed allocation factors determined?

A. We interviewed a number of PacifiCorp managers and elicited their views as to appropriate cost-causation factors applicable to their business units. We also examined service company contracts that are being used by other registered holding company systems in the United States and sought expert legal advice in respect to them.

Q. What economic impact will the Contract have on PacifiCorp's customers?

A. The revenue requirement modeling of the Contract is discussed in Mr. David Taylor's testimony. Generally speaking, the impact results in minimal cost shifts among jurisdictions ranging from -0.6% to 0.2% over the 30-year analysis.

Q. Why does this cost shift occur?

A. Presently, PacifiCorp's administrative and general costs are allocated among retail jurisdictions using the "SO" factor, which is based upon total plant in service. Under the Contract, more precise cost allocation factors are used, which result in somewhat different amounts of administrative and general costs being allocated to the state electric companies than are allocated among state jurisdictions under current ratemaking practices.

Q. Does this conclude your supplemental direct testimony?

A. Yes.