I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Richard M. Anderson, 39 W. Market Street, Suite 200, Salt Lake City, Utah, 84101.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am a principal in the firm of Energy Strategies, LLC. Energy Strategies is a professional consulting firm offering services in the natural gas and electric industries. Our clients are typically large industrial entities who, by their nature, consume substantial amounts of natural gas and/or power.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I received a Bachelor of Business Administration degree from the University of Texas-Austin and a Ph.D. in Economics from the University of Utah.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I have approximately 20 years of work experience in the energy field. The work has centered on economic analyses and policy assessments on a variety of energy issues. During the last five years I have provided direct testimony in various regulatory proceedings before the Idaho, Oregon, Utah and Wyoming public service/utility commissions.

Attached as Exhibit RMA-1 is a brief resume that provides more specifics as to my professional experience.

Q. ON WHOSE BEHALF ARE YOU FILING TESTIMONY IN THIS PROCEEDING?

A. I am filing testimony on behalf of the Utah Association of Energy Users Intervention Group and Nucor Steel, a Division of Nucor Corporation.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will address PacifiCorp's wholesale power marketing strategy, historically and as it changed in the mid-1990s, as well as the consequences of the same for the test year in this case, the 12 months ending September 30, 2000. Of particular concern is the economic risk that accompanies the Company's wholesale market strategy that was implemented in the mid-1990s. The end result of the economic risks created by changes in the Company's wholesale strategy now must be absorbed. My testimony will address who should absorb the economic cost associated with the Company's aggressive wholesale market endeavors.

Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR CONCLUSIONS.

A. My conclusions can be summarized as follows:

1. There was a purposeful shift in PacifiCorp's wholesale power market strategy beginning in approximately 1995, which led to a substantially greater presence and participation by PacifiCorp in the wholesale power market, far beyond the level necessary to serve retail customers.
2. PacifiCorp's wholesale market activities beginning in 1995 were predicated on a business model that backed long-term wholesale commitments with short-term purchases.
3. Although there were dramatic changes in PacifiCorp's internal business philosophies and wholesale activities over the past six years, and in the

market structure itself, there have been no corresponding changes in the methods and procedures for allocating risks, costs or revenues associated with the wholesale market.

4. The Company's filing fails to acknowledge or reflect a proper link between the Company's business decisions and the business risks associated with those decisions.
5. The Company should absorb the economic cost associated with increased business risks resulting from its internal decisions.

II. HISTORICAL PERSPECTIVE ON PACIFICORP'S WHOLESALE MARKET ACTIVITIES AND RATEMAKING

Q. REVENUE FROM WHOLESALE TRANSACTIONS TODAY IS ACCOUNTED THROUGH A REVENUE CREDIT MECHANISM. HAS THIS ALWAYS BEEN THE CASE?

A. No. For a number of years prior to the 1989 merger with PacifiCorp, Utah Power's rate filings with this Commission utilized an energy balancing account for energy costs and a "FERC jurisdiction" to account for wholesale sales revenues and costs. In May, 1990, shortly after the merger with PacifiCorp was approved, Company witnesses offered testimony in Docket No. 90-035-06 that proposed use of (i) a production cost model to estimate power costs and (ii) a revenue credit mechanism for wholesale revenues. A modified version of the revenue credit proposal was submitted by stipulation and approved by the Commission. The stipulation included certain "safeguards" designed to protect ratepayers from some of the risks associated with wholesale transactions.

In addition, a task force was created by the Commission to examine issues in connection with the new approach to net power costs. The task force proposed the following safeguard: "Pricing shall be structured such that over the life of the contract retail revenue requirement will be protected from the increases resulting from resource acquisitions needed to serve the wholesale contract." (Wholesale Contracts Task Force Report, April 1993, Revised Standard 4.D.) All parties to the Task Force agreed to the proposed standard.

Q. WHAT ARGUMENTS WERE OFFERED BY PACIFICORP IN SUPPORT OF A WHOLESALE REVENUE CREDIT APPROACH?

A. PacifiCorp witnesses Verl Topham and Greg Duvall testified in support of replacing the separate class cost of service approach for wholesale transactions with a production cost model/revenue credit approach as a vehicle for regulatory oversight. According to these witnesses, the production cost model would estimate and normalize net power costs and the revenue credit mechanism would credit retail customers with the proceeds of wholesale sales transactions. Both witnesses stressed that the wholesale power market had undergone structural changes and had become much more competitive. The witnesses emphasized that, as a result, pricing strategies among wholesale power sellers had also changed. According to PacifiCorp, it had become common for wholesale sellers to offer discounted pricing on the "front end" of a contract due to the competitiveness of the market. The Company witnesses expressed the fear that a contract measured initially against average embedded system cost (as was done under the FERC jurisdiction approach) might never be entered into, even though it may offer a positive benefit to ratepayers over the life of the contract.

The import of the Company's argument was that the regulatory tool that had been used for many years was no longer appropriate in a market setting where both the Company's actions and the competitiveness of the market itself were vastly different than in prior years.

III. RISK ALLOCATION FOR WHOLESALE MARKET TRANSACTIONS

Q. DID THE CHANGE IN REGULATORY APPROACH TOWARD NET POWER COSTS ALTER THE ALLOCATION OF RISKS INVOLVED IN WHOLESALE TRANSACTIONS?

A. Yes. Mr. Topham emphasized that the elimination of the Energy Balancing Account (EBA) (which had been employed in the pre-merger Utah Power) and the use of a production cost model entailed a different approach toward allocating risk. Under the Company's proposed scheme, business risks stemming from the wholesale market would be placed upon the Company. Mr. Topham emphasized:

> *"The Company is willing to accept this risk because we believe the risk is manageable. The Company believes in placing the risk of management practices on those that make the business decisions – management – not customers."* (Testimony of Mr. Verl Topham, Utah Docket No. 90-035-06, p. 13) (Emphasis added)

It was the Company's intent that business risks associated with wholesale market activities – risks voluntarily assumed by the Company because it could control and manage the same – would be borne by the Company, and not by its customers. Risks outside the reasonable control of the Company – such as weather and other risks of nature – remained the ultimate responsibility of ratepayers, through the normalization procedures of the power cost model.

Q. IS THE SOURCE OR NATURE OF RISKS ASSOCIATED WITH NET POWER COSTS OF SIGNIFICANCE?

A. Yes. There is a necessary and logical link between the nature of the risk faced and the ability to manage that risk. Ratepayers properly bear risks that arise out of acts of nature, like variations in hydro conditions and the concomitant changes in hydropower production. Such risks are difficult to predict or mitigate. The power cost modeling procedure is intended to normalize these types of risks. In contrast, risks that are the product of wholesale power market transactions remain outside the normalization process.

Q. DID THESE MECHANISMS INITIALLY SUCCEED IN ASSIGNING RISKS AS INTENDED?

A. Partially, at least as to some risks. The mechanisms implemented were intended to address risks of nature and the risks associated with market sales out of excess generation and market purchases necessary to serve retail load. These were the "market risks" existent in the energy environment of the early 1990s. Between rate cases, the Company absorbed the outcomes of its successes and failures in managing these risks. The production cost model "smoothed out" certain risks of nature. The revenue credit approach permitted the Company to enter into wholesale sales transactions when, in the Company's judgment, revenues exceeded variable costs over the life of a contract. These mechanisms were not, however, designed nor adequate to deal with long-term business risks associated with the aggressive participation in wholesale markets initiated by Company management in 1995.

Q. WAS THE PRESENCE OF BUSINESS RISK RECOGNIZED AT THE TIME?

A. Yes. Exhibit RMA-2, a January 1993 Memorandum from the Utah Public Service Commission to the Company, the Division of Public Utilities, the Committee of Consumer Services and other interested parties, includes a discussion of the production cost model utilized by the Company and the ratemaking treatment of net power costs. As noted by the Commission memo, proper ratemaking treatment of net power costs is linked to the nature of the associated risks. The Commission explained: "The answer to these questions requires the determination of the nature of the risk associated with the variability and predictability of the net power costs and how those risks can be mitigated." The Commission also stated: "If the risks can be effectively managed by the Company then there is a strong argument for the Company accepting such risks." (Commission Memorandum, January 25, 1993, page 2.)

Q. IT APPEARS THAT THE COMMISSION'S VIEW PARALLELS THAT OF MR. TOPHAM. IS THAT YOUR OPINION?

A. That is correct. Moreover, the Commission approved elimination of the EBA as proposed by Mr. Topham. Presumably, in doing so, the Commission intended to allocate to the Company business risks within its control and management. This was in keeping with Mr. Topham's position that business risks should be placed with those who make business decisions.

Q. DID THE COMMISSION HAVE CONCERNS REGARDING RISKS ASSOCIATED WITH THE DETERMINATION OF NET POWER COSTS?

A. Yes. The above-mentioned memo (Exhibit RMA-2) also discussed the types of risks that underlie net power cost calculations. The Commission sought clarification on the types of risks that might exist: "to date, there has been little discussion of the nature of the risks associated with net power costs, from where do they stem?" More importantly, the Commission asked: "Are the variances in net power costs the result of weather considerations or market transactions or coal costs or some other variables?" (Commission Memorandum, January 25, 1993, page 3.)

The Commission memo quoted above was written in 1993. The issue before the Commission involved the appropriate ratemaking treatment of net power costs. At that time, the level of wholesale power purchases and sales was relatively small and was driven primarily by management of loads and resources for retail customers.

IV. DRAMATIC CHANGES IN THE COMPANY'S WHOLESALE ACTIVITIES AND STRATEGIES

Q. PLEASE DESCRIBE HOW THE COMPANY'S WHOLESALE MARKETING ACTIVITIES CHANGED.

A. In the early 1990s, wholesale sales constituted about one quarter of total system sales. As shown in Exhibit RMA-3, purchased power ranged from about 14 to 18 percent of total system energy. From 1992 to 1995, the percentages of both purchased power and wholesale sales remained relatively constant. The likely cause of variations during this time period was yearly changes in prevailing hydro conditions. Thus, the predominate risk underlying net power cost was the type of natural risk noted above. Business risks associated with wholesale market transactions played a relatively minor role in this time period. This changed significantly beginning in the 1995-96 time period. At that point in time the Company dramatically expanded its wholesale sales activities. As a result, risks stemming from business decisions began to play a much more prominent role in the Company's wholesale transactions.

Q. WHAT IS THE COMPANY'S EXPLANATION FOR WHY THE LEVELS OF WHOLESALE PURCHASES AND SALES INCREASED SO DRAMATICALLY?

A. PacifiCorp apparently claims that it's participation in wholesale markets throughout the 1990s was driven primarily by the need to balance resources and minimize costs to retail customers. Mr. Stan Watters, Managing Director of Wholesale Energy Services for PacifiCorp, has recently stated, "we believe we were successful in matching loads and resources, thereby minimizing the extent of the Company's exposure to purchases on the wholesale market." (Mr. Stan Watters, Rebuttal Testimony, UE-116, Oregon Public Utility Commission, May 2001, page 16.)

Q. DO YOU AGREE WITH PACIFICORP'S CONTENTION?

A. No, at least not insofar as it relates to the late 1990s. In the early part of the last decade, PacifiCorp acquired several generating resources that became available. PacifiCorp acquired the 350 MW Cholla Unit 4 from Arizona Public Service Company in 1990 and 243 MW of generation from Colorado-Ute Electric Association's Craig and Hayden units in 1992. As a result of these and other resources, PacifiCorp had significant excess capacity and entered into a number of wholesale power sales contracts to dispose of the surplus while it waited for it's retail loads to grow into its resources. Please refer to Exhibit RMA-4, "PacifiCorp and the Wholesale Market: An Overview", the Company's February 1993 strategy on wholesale power sales and purchases (PacifiCorp Response to UAE Data Request 2.14)

Q. DO YOU HAVE CONCERNS OVER THESE TYPES OF WHOLESALE CONTRACTS ENTERED INTO IN THE EARLY 1990s?

A. Assuming that the Company's acquisition of resources was prudent, market transactions designed to dispose of excess power temporarily, at prices above the marginal cost of the unit, such as PacifiCorp's early 1990's wholesale power sales contracts, would appear to be reasonable.

Q. DID PACIFICORP'S WHOLESALE MARKETING ACTIVITIES AFTER 1995 REFLECT A CONTINUED EFFORT TO BALANCE RETAIL LOAD AND RESOURCES?

A. While this appears to have been largely true during the first half of the 1990s, an abrupt change in management direction occurred after Mr. Fred Buckman became CEO in 1994. A review of PacifiCorp's actions since that time clearly shows that PacifiCorp's wholesale marketing activities were not geared primarily toward balancing retail loads and resources. Rather, PacifiCorp embarked on a path to amass a significant wholesale marketing business in the western region and throughout the United States. In addition, it took the deliberate gamble of relying on short-term market purchases to fulfill long-term sales commitments. Unfortunately, PacifiCorp is attempting to pass on the economic costs of these decisions and gambles to ratepayers today.

Q. ARE THESE CHANGES IN THE COMPANY'S WHOLESALE POWER MARKETING STRATEGY DOCUMENTED?

A. Yes. For example, PacifiCorp's 1994 Annual Report, in Mr. Buckman's first year as CEO, prominently showcased the emerging importance placed by the Company on its wholesale business:

> "Through 1995, PacifiCorp expects to emerge as a national presence in marketing, brokering and trading. The company will sell both electricity commodities and services, and will aggressively pursue new markets." (PacifiCorp Annual Report, 1994, page 3.)

PacifiCorp's 1996 Annual Report also emphasized global sales, marketing and energy trading. One revealing extract from those pages follows:

> "As the leading bulk-power trader in the West, PacifiCorp continues to experience double-digit growth in the wholesale part of the business. Our ability to anticipate and respond to market changes has enabled us to

> strengthen our position. For example, as a result of variations in the western wholesale power market, we increased our focus on the short-term market. … PacifiCorp anticipates another exceptional year in 1997 as we continue to develop our expertise, pursue new opportunities and develop the kinds of new products that meet the needs of our large wholesale customers." (PacifiCorp Annual Report, 1996, page 10.)

Q DID THE COMPANY SLOW ITS PURSUIT OF WHOLESALE TRANSACTIONS IN LIGHT OF INCREASING COMPETITION?

A. No. To the contrary, in 1997 PacifiCorp continued to tout its "aggressive growth" in wholesale power marketing throughout the continental United States, while showcasing its wholesale power business in the west:

> "Through our western wholesale power marketing business we have a significant presence in the western U.S., where we are the leading bulk trader among investor-owned utilities." (PacifiCorp Annual Report, 1997, page 12.)

Q. DID RETAIL LOADS OR MINIMIZATION OF RETAIL RATES DRIVE PACIFICORP'S WHOLESALE MARKETING EFFORTS IN THIS PERIOD?

A. No. The Company no longer simply sold excess power from its generating resources until it was needed for retail loads. Rather, the Company embarked on a new strategy to grow its wholesale business by dramatic proportions. Significantly, it also accepted significant business risks by committing to long-term sales commitments without sufficient generation or long-term purchased power resources to meet its obligations. The Company elected to gamble on short-term wholesale market prices. The Company elected to maintain 'open positions' on its long-term commitments, a strategy that carries substantial business risk.

Q. CAN YOU ILLUSTRATE THE GROWTH OF PACIFICORP'S WHOLESALE POWER BUSINESS DURING THIS TIME PERIOD?

A. Yes. Exhibit RMA-5 is a time series graph depicting wholesale power sales as a percentage of total system sales and wholesale power purchases as a percentage of total system energy. As can be seen in the exhibit, there was a substantial increase in the Company's wholesale sales and purchases during the last part of the decade. For example, wholesale sales constituted 24 percent of system sales at the time of the 1993 Commission memo cited above, but by 1997 that percentage had grown to 54 percent. While the percentages have declined since reaching their peaks in 1997, the percentages over the last few years still remain very high compared to the earlier part of the decade. Wholesale purchases were likewise increasing dramatically.

Q. DID PACIFICORP NEED TO INCREASE WHOLESALE POWER PURCHASES BY OVER THREE-FOLD BETWEEN 1993 AND 1997 TO MEET RETAIL LOAD GROWTH?

A. No. As shown in Exhibit RMA–6, PacifiCorp's energy sales to retail customers during the 1993-1997 period increased by only 3.7 million MWH, while its purchased power increased by 45 million MWH. During that time period, PacifiCorp's retail load represented 81% to 85% of PacifiCorp's net generation.

PacifiCorp was thus in a "long" resource position and did not require significant increases in purchased power to serve the retail side of the business. It was the wholesale sales efforts (documented in PacifiCorp annual reports) that drove PacifiCorp's wholesale power purchases. PacifiCorp's wholesale market strategy was the driving force for increases in purchased power during this time period.

Q. WAS PACIFICORP'S SHIFT TO GREATER INVOLVEMENT IN THE WHOLESALE POWER MARKETS INTENTIONAL?

A. Yes. The Company followed a purposeful course of greater involvement in the wholesale power market. During the 1996-1998 time period the western wholesale power market witnessed major structural changes that led to increased competition and lower wholesale prices. Following the initiative established with the passage of the Energy Policy Act of 1992, transmission access became more available and the number of players in the market increased significantly. Wholesale price indexes were established to facilitate greater volumes of transactions. PacifiCorp elected to become a major player in this emerging competitive wholesale market.

Exhibit RMA–7 was offered by Mr. Stan Watters of PacifiCorp at the April 2, 2001 "PacifiCorp's Power Cost Workshop" in support of the Company's power cost filings in Oregon. In the exhibit, Mr. Watters explained that the Company's "trading activities . . . increased to take advantage of market liquidity and maintain a market presence" and "sales were system sales backed by the overall portfolio of resources *including market purchases*." (PacifiCorp, *Benefits of*

Wholesale Market Strategy, Stan Watters, April 2, 2001, page 13.) (Emphasis added.)

Q. WAS THE EXPANSION IN "TRADING ACTIVITES" NOTED BY MR. WATTERS DIRECTED BY A STATED WHOLESALE POLICY?

A. Yes. The Company developed annual Marketing Plans that provided objectives, targets and specific marketing opportunities. The marketing plans, which are marked confidential, were provided in response to CCS Data Response 2.12. These plans were meant to provide guidance to those making wholesale transactions. Beginning as early as the 1995 plan, it is evident that senior management at the Company felt that the wholesale market provided excellent opportunities for revenue enhancement for the Company. The marketing plans reflect a manifestation of the pronouncements contained in the annual reports of the Company beginning as early as 1994.

Q. ARE YOU AWARE OF ANYTHING ELSE THAT INDICATES THAT THE COMPANY ADOPTED A NEW STRATEGY TOWARD WHOLESALE ACTIVITIES?

A. Yes. A portion of PacifiCorp's transcription of the interchange among parties at a RAMPP-5 meeting on August 15, 1997 is attached as Exhibit RMA–8. Of particular interest is an announcement by Ms. Carrie Plemons, who was responsible for wholesale activities of the Company. She confirmed that the

Company wanted to change its approach to modeling wholesale sales in the RAMPP model. She stated:

> "I want to talk about the RAMPP-5 strategy to balance out the long-term wholesale sales. One way of removing the impact of wholesale activities on the RAMPP process is to fully support those with purchases in the marketplace. By 2002 we would be fully supporting our long-term sales with group purchases."

Similarly, a letter sent by the Company to announce the August 15 RAMPP meeting highlighted the importance of wholesale activity. Exhibit RMA-9 is a letter dated August 1, 1997, from Ms. Nancy Esteb. Page two of that letter states:

> "The second issue, wholesale transactions, involves recognizing the increasing volume of wholesale transactions and the company's goal to rely on the wholesale market to meet those needs. *The company's goal is to match wholesale sales with sufficient megawatts to wholesale purchases over the next few years.* Planning should recognize this planned balancing of wholesale sales with wholesale purchases." (Emphasis added.)

Q. DOES THE NORMALIZATION PROCESS FULLY ADDRESS CHANGES IN WHOLESALE MARKETING STRATEGY?

A. No. The normalization process used for ratemaking purposes reduces year to year variations in the actual data. The Company's normalization approach tends to level out variations due to weather, unplanned outages, and other unavoidable natural effects, but it does not alter trends. The Company altered its wholesale strategy beginning in 1995 and has never returned to the pre-1995 levels of wholesale transactions, even after adjusting for retail system growth.

V. INCREASED RISKS STEMMING FROM CHANGES IN WHOLESALE ACTIVITIES.

Q. DID THE COMPANY RECOGNIZE THAT ITS NEW WHOLESALE MARKET STRATEGY CREATED INCREASED RISKS?

A. Yes. The Company clearly understood that increased activity in the wholesale market, coupled with a strategy to back-up long-term commitments with short-term purchases, resulted in a substantial possibility of both higher rewards and higher risks. Exhibit RMA–10 reflects page 11 of the minutes of the RAMPP-5 meeting held on April 26, 1996, and captured the following exchange between Mr. Ken Powell of the Utah Division of Public Utilities and Mr. Gordon McDonald of PacifiCorp:

> [Mr. Powell]: "A few years ago the Company said the wholesale business was a way to mitigate and soften rate impacts to retail customers. I'm not sure the Company sees itself that way anymore. I think the Company is changing the viewpoint, so we'd like to know what the viewpoint is."
>
> [Mr. McDonald]: "We use wholesale revenues as a revenue credit to benefit retail customers. … However, margins are so much thinner in the wholesale market that it's not what it used to be. We can see ways that might make the business more profitable to counteract the tremendous thinning down of wholesale margins, *but there's a lot of risk associated with that."* (Emphasis added.)

Q. DID PACIFICORP UNDERTAKE AN ASSESSEMENT OF THE WHOLESALE MARKET TO GAIN A BETTER UNDERSTANDING OF MARKET CONDITIONS?

A. No. DPU Data Request No. 13.1 asked the Company to provide all analyses performed or conducted by the Company over the last five years on the supply and demand of electricity in the WSCC region. The Company's response is telling:

> "The Company has not performed an analysis of the supply and demand in the WSCC region. The Company has only analyzed its own load and resource mix. … (Response to DPU Data Request No. 13.1.)

Q. WHAT HAPPENED TO WHOLESALE ELECTRICITY PRICES IN THE WESTERN UNITED STATES IN THE PERIOD MAY TO SEPTEMBER, 2000?

A. The price indexes for on-peak spot energy at the major western trading hubs soared

	May 1, 2000	August 15, 2001
COB	$35.78	$194.50
Four Corners	$36.70	$235.00
Mid-Columbia	$34.68	$193.00
Palo Verde	$39.88	$232.16

Q. DID THESE INCREASES IN SHORT-TERM WHOLESALE POWER PRICES IMPACT THE FINANCIAL EXPOSURE OF PACIFICORP'S WHOLESALE POWER SALES OBLIGATIONS?

A. Yes, dramatically. When western wholesale power prices soared in the spring of 2000, there was a corresponding increase in the amount of PacifiCorp's economic exposure since short-term purchased power contract prices (on which the Company was relying to meet long-term obligations) were now significantly higher.

Q. WHO SHOULD BEAR THIS INCREASED RISK?

A. Recall PacifiCorp's 1990 testimony in Docket 90-035-06 advocating the adoption of a production cost model/revenue credit. Mr. Topham argued that business risks associated with net power costs should be assigned to the utility. The Company made the business decision to dramatically expand its wholesale activities and to maintain open positions, thus gambling on market prices. The business risks associated with those business decisions and activities should be borne by the Company – the only one with the ability to manage that risk.

Q. WERE THESE INCREASED MARKET PURCHASES NEEDED TO MEET RETAIL LOAD?

A. No, and this is an important point. If the Company's increased market purchases were solely attributable to the Company's need to meet its retail load growth, the issues and analysis in this case would be very different. However, where the increase in market risk is attributable to the pursuit of perceived opportunities in the wholesale market or imprudent management decisions, the increased risk is unnecessary from the ratepayers' standpoint.

Q. WHY DO YOU CONCLUDE THAT THE COMPANY'S INCREASED MARKET ACTIVITY WAS NOT NECESSARY TO MEET RETAIL LOAD?

A. Between 1992 and 1999, the company's wholesale sales increased by approximately 71%, while its retail sales increased approximately 12%. This increase in wholesale activity was far beyond that needed to meet system growth. The Company's wholesale activities were driven largely by the business desire discussed above to enhance the Company's wholesale presence, and were largely independent of its retail requirements. The Company purposefully undertook a deliberate wholesale strategy that significantly increased economic exposure. The risks accompanying that strategy should properly be assigned to those who made the decisions, and who had the ability to manage the risks.

Q. HAVE YOU DONE AN ANALYSIS THAT SUPPORTS YOUR ASSERTION THAT PACIFICORP HAS MADE SHORT-TERM POWER PURCHASES IN EXCESS OF THE NEEDS OF ITS RETAIL LOAD?

A. Yes, Exhibit RMA-11 contains tables summarizing an hourly analysis of PacifiCorp's loads and resources. The analysis utilized data provided by the Company (Response to Retail/Wholesale Revenue Requirement Forum Request 3b and 3a Supplemental). The following table is a summary of the results of this analysis:

Percent of Long term Purchase Contract Applied	Annual STF Required to Balance PacifiCorp East	Annual STF Required to Balance PacifiCorp West	Annual STF Required to Balance PacifiCorp Total
100%	0%	11.39%	7.99%
75%	0%	14.74%	10.34%
50%	0%	18.66%	13.09%

Note: STF = Short term firm purchased power.

Q. WHAT CONCLUSIONS DID YOU DRAW FROM THIS ANALYSIS?

A. During the test year, PacifiCorp was clearly buying a significant quantity of short term purchased power far in excess of its retail load requirements for the test year. PacifiCorp's behavior is consistent with the business strategy that the Company embarked on in 1995. My analysis has quantified a cost of approximately $1.8 billion for purchases of short-term power by PacifiCorp in the test year that were above and beyond the needs of system retail requirements.

Q. WILL YOU DESCRIBE SOME OF THE SIMPLFYING ASSUMPTIONS USED IN THE ANALYSIS?

A. This analysis was conducted for the PacifiCorp East (PCE) load control area, the PacifiCorp West (PCW) load control area and the combined Total Company. Certain simplifying assumptions used in this analysis are discussed below

The analysis assumes that all PacifiCorp owned generation is applied to meet retail loads. Second, the hourly long-term purchased power (including unit specific and intermediate purchase power contracts) was used to meet retail load requirements at three different percentages – 100%, 75%, and 50%. All exchanged and transferred power coming into each load control area is also included. The analysis also included power exchanges and transfers out of the load control area with the retail load. Third, the analysis used short term firm purchased power to balance resources and load within a control area, if necessary, for each hour of the test year. The Net Power Cost Model uses Non-Firm Secondary Power Purchases to balance the system, however, the prices used in the model for short term firm purchased power and non-firm secondary purchased power are essentially the same.

VI. QUANTIFYING THE INCREASED COST STEMMING FROM CHANGES IN SIX WHOLESALE POWER SALES CONTRACTS.

Q. HAVE YOU REVIEWED THE WHOLESALE POWER SALES CONTRACTS THAT PACIFICORP WAS INVOLVED WITH DURING THE TEST YEAR?

A. Yes, I have. I have reviewed all wholesale power sales contracts that PacifiCorp entered into since 1995. A listing of those contracts is included in PacifiCorp's Response to CCS Data Request 2.16a, attached as Exhibit RMA-12. Based on my review of this document and subsequent analysis of the contracts and other information, I have several concerns about various aspects of those contracts.

Q. WHAT IS YOUR CONCERN ABOUT PACIFICORP'S POST 1995 WHOLESALE POWER SALES CONTRACTS?

A. I am concerned that PacifiCorp entered into long-term contracts under circumstances where PacifiCorp was following a business plan to increase wholesale market penetration, and that those contracts have negatively impacted the net power cost during the test year.

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At least four of PacifiCorp's post-1995 wholesale power sales contracts are long-term, low cost, fixed price contracts with utilities who are buying power for delivery to specific customers outside of PacifiCorp's service territories. None of these contracts have any provisions to protect PacifiCorp from significant changes in the market during the contract term:

- The 221 MW Hinson Power sale is for the benefit of the Columbia Falls Aluminum Company, a former BPA Direct Service Industry customer. (RAMPP-4, September 22, 1995 Meeting notes, page 1); This contract ran from April 1996 to December 31, 2000 with an average price of $23 per MWh.

- The 10 MW Cowlitz sale, on the behalf of BHP steel. This is a contract that runs from April 28, 1997 to April 30, 2002 at an average price of $17.61 per MWh.

- The Clark PUD 10 MW purchase for WaferTech at an average cost of $16.30 per MWh for the contract period December 1, 1997 to November 30, 2002.

- The Clark PUD 10 MW purchase for FiberWeb at an average cost of $16.62 for the contract period September 29, 1997 to September 30, 2000.

  (Source: Test Year Average Costs based on PacifiCorp Response to CCS Data Request 11.2g)

Q. WHAT BASIS DID PACIFICORP MANAGEMENT USE TO APPROVE THE HINSON-COLUMBIA FALLS ALUMINUM COMPANY WHOLESALE POWER SALES CONTRACT?

A. PacifiCorp has provided little information regarding this question. CCS Data Request 17.1(f) asked for all PacifiCorp documentation used as the basis for justifying the terms of the 1996 Hinson-Columbia Falls Aluminum contract:

> Please provide a copy of any internal memo, letter, presentation, or analysis that served as the basis for justifying the terms of these contracts to the appropriate internal Company authority before these contracts were ultimately agreed to by the Company.

PacifiCorp responded that it had no documentation for the Hinson contract:

> Due to the length of time since the contract had been negotiated and signed, the Company is unable to locate the information requested at the present time.

PacifiCorp's response is surprising in light of the fact that it has negotiated a number of Hinson contracts as recently as January 28, 1998 ("Long-term power sales agreement, PacifiCorp Response to CCS Data Request 17.2) for a contract that became effective within this test year, October 1, 1999.

Q. DOES PACIFICORP CONTEND THAT THE HINSON CONTRACT'S "ECONOMIC SHAPING" PROVIDES BENEFITS TO THE COMPANY?

A. Yes. PacifiCorp estimated $1.9 million of economic benefits from shaping during the test year. (PacifiCorp Response to CCS Data Request 17.2f(ii)).

Q. WHAT BASIS DID PACIFICORP MANAGEMENT USE TO APPROVE THE WHOLESALE POWER SALES CONTRACTS FOR CLARK-FIBERWEB, CLARK-WAFERTECH AND COWLITZ-BHP?

A. Again, no documentation has been made available for any of these contracts. PacifiCorp was also asked for underlying contract documentation for the Clark-Fiber Web, Clark-WaferTech and Cowlitz-BHP contracts. (CCS Data Requests 17.4g, 17.5g and 17.16f). In each case, PacifiCorp repeated its response for the Hinson contract:

> Due to the length of time since the contract had been negotiated and signed, the Company is unable to locate the information requested at the present time.

Q. WHAT WERE THE SALES LEVELS OF THESE FOUR CONTRACTS DURING THE TEST YEAR ENDED SEPTEMBER 30, 2000?

A. As shown in Exhibit RMA-13, total test year sales for the four contracts was 900,606 MWH with test year revenue of $19,270,137, an average price of $21.40 per MWH.

Q. DOES PACIFICORP CONTEND THAT THE COWLITZ-BHP, CLARK-FIBERWEB AND CLARK-WAFERTECH CONTRACTS PROVIDE BENEFITS TO THE COMPANY?

A. There is no record evidence of any alleged benefits relating to these three contracts.

Q. PLEASE ESTIMATE THE IMPACT OF THESE FOUR CONTRACTS ALONE ON PACIFICORP'S NET POWER COSTS FOR THE TEST YEAR.

A. Exhibit RMA-13 calculates PacifiCorp's cost exposure resulting from following it's post-1995 corporate policy of meeting its wholesale power sales commitments from the short-term wholesale market for the four wholesale power sales contracts that I have been describing. PacifiCorp witness Widmer (Supplemental Direct Testimony, page 10, lines 5-12) has used $108.89 as a proxy for the most recent short-term wholesale power costs. This was the cost of short-term power over the June-September, 2000 period.

> As a result of the significant increase in wholesale market prices that occurred during the test year and the expectation that high prices will continue, short-term wholesale sales and purchase prices are based on actual prices incurred by the Company for the period June 2000 through September 2000.

Based on PacifiCorp's own assumptions regarding short-term firm prices and the wholesale market strategy it employed, PacifiCorp's test year resource cost to meet the obligations of these four contracts was $98,066,987. Test year revenue was $19,270,137 for these four contracts. This results in a test year net loss of $78,796,850 for these four contracts alone.

Q. DO YOU HAVE OTHER CONCERNS ABOUT PACIFICORP'S POST-1995 WHOLESALE POWER SALES CONTRACTS?

A. Yes. In March 1997, PacifiCorp entered into letter agreements with San Diego Gas & Electric and the Springfield Utility Board. I am concerned about the nature of these contracts, a series of one-year "short-term" contracts, all signed on the same day, with minimal to no contractual protection from market price aberrations during the contract period. Again, similar to the contracts discussed above, PacifiCorp claims that no internal documentation is available on the Springfield contract (PacifiCorp Response to CCS Data Request 17.11f.).

Q. PLEASE COMMENT ON THE SAN DIEGO GAS & ELECTRIC CONTRACT.

A. Basically, this is a series of four nearly identical letter agreements for four successive years of one-year firm service for 100 MW of power delivered at a 100% load factor (876,000 MWH per year) at a flat rate of $16.45 per MWH. The $16.45 per MWH flat rate remains constant throughout the four year term of the four contracts.

Even though it is a four year contract, four separate one year contracts, each signed at the same time and each one having the same flat price of $16.45 per MWH, PacifiCorp had until recently, characterized it as a short-term contract. This contract was not listed in PacifiCorp's Response to CCS Data Request 2.16a and was included in short-term sales in PacifiCorp's test year power cost modeling. Just recently, the San Diego Gas & Electric contract has been characterized as a long-term wholesale power sales contract in Mr. Widmer's rebuttal testimony in Oregon's UE-116:

> The Company had signed successive one-year contracts at the request of a few customers. These contracts collectively operate as a long-term contract. For example, on March 24, 1997 the Company signed four one-year contracts (1998-2001) with San Diego Gas and Electric on the same day. Sales of this type are accounted for and included in the Company's FERC Form 1 as short-term firm sales because each of the contracts fits the definition for short-term firm, since they have a term of one year.

> However, this type of transaction functions as a long-term contract and should be treated as such… (UE-116 April, 2001 Rebuttal Testimony of Mark Widmer, page 8, lines 1-8)

Mr. Widmer's UE-116 rebuttal testimony Exhibit PPL1004 provides additional information on the San Diego Gas & Electric contracts:

Year	$ Revenue	MWH	$/MWH
1998	$14,410,200	876,000	$16.45
1999	$14,410,200	876,000	$16.45
2000	$14,410,200	876,000	$16.45
2001	$14,410,200	876,000	$16.45

Q. DOES THIS CONTRACT PROVIDE ANY FLEXIBLITY TO PACIFICORP IF WHOLESALE POWER PRICES WERE TO DRAMATICALLY CHANGE?

A. Apparently not.

Q. DOES PACIFICORP CONTEND THAT THE SAN DIEGO GAS & ELECTRIC CONTRACTS PROVIDE BENEFITS TO THE COMPANY?

A. I have not seen any documentation making such a claim.

Q. PLEASE COMMENT ON THE SPRINGFIELD II ELECTRIC CONTRACT.

A. Basically, this is a series of five letter agreements for five successive years of service for 50 MW of power delivered at 100% load factor for September through April. The contract consists of two 25 MW blocks of power, one related solely to delivery during October-March with the other block supplying 25 MW on a monthly basis for September-April. This contract, unlike the San Diego Gas & Electric, contract contains different fixed pricing for each year: The monthly pricing for September-April is as follows:

Monthly Pricing (per MWH)	
1997/98	$16.55
1998/99	$17.44
1999/2000	$18.09
2000/2001	$18.96
2001/2002	$20.39

(Source: PacifiCorp Response to Retail/Wholesale Revenue Requirement Forum Data Request 1a)

Q. WHAT BASIS WAS USED BY PACIFICORP MANAGEMENT IN APPROVING THE WHOLESALE POWER SALES CONTRACTS FOR SPRINGFIELD II?

A. Again, no documentation has been made available for this contract. PacifiCorp again referenced its response for the Hinson contract (CCS Data Requests 17.11f).

Q. DOES PACIFICORP CONTEND THAT THE SPRINGFIELD II CONTRACTS PROVIDE BENEFITS TO THE COMPANY?

A. I have not seen any documentation making such a claim.

Q. DOES THE SPRINGFIELD II CONTRACT HAVE FLEXIBLITY IF WHOLESALE POWER PRICES WERE TO DRAMATICALLY CHANGE?

A. No. The contract has only a nominal escalation in its annual energy charges, but certainly, was not drafted to react to changes in wholesale power market conditions.

Q. **PLEASE ESTIMATE THE IMPACT OF THE SAN DIEGO GAS & ELECTRIC AND SPRINGFIELD II CONTRACTS ON PACIFICORP'S NET POWER COSTS FOR THE TEST YEAR**

A. I have made an analysis of the San Diego Gas & Electric and Springfield II contracts, similar in nature to my analysis of the first four contracts that I discussed earlier in my testimony. As shown in Exhibit-RMA-13, sales revenue for the two contracts for the test year was $17,218,666. Based on PacifiCorp's own assumptions of purchased power on a daily basis at $108.89 per MHW, the test year resource cost for the San Diego and Springfield II contracts was $111,286,451. This is a test year net loss of $94,067,785 for these two contracts alone.

Q. PLEASE SUMMARIZE THE NET POWER COST IMPACT OF PACIFICORP'S WHOLESALE SALES CONTRACTS TO THE SIX CUSTOMERS YOU HAVE MENTIONED SO FAR.

A. As shown in Exhibit-RMA-13, the test year impact of PacifiCorp's wholesale sales contracts with San Diego Gas & Electric, Springfield II, Hinson-Columbia Falls Aluminum, Clark-FiberWeb, Clark-WebTech and Cowlitz-BHP is a net loss of $172,864,635 on sales revenue of $36,488,803. Using an SG factor of 37.1436%, this results in a net loss of $64,208,149 for the Utah jurisdiction.

Q. YOU CONTEND THAT PACIFICORP'S POST-1995 WHOLESALE POWER SALES CONTRACTS ARE EMBLEMATIC OF THE BUSINESS STRATEGY THAT RESULTED IN EXTRAORDINARY RISK AND ECONOMIC EXPOSURE TO POTENTIAL INCREASES IN POWER PRICES. WHAT IS THE IMPACT OF ALL OF PACIFICORP'S POST-1995 WHOLESALE POWER SALES CONTRACTS?

A. Exhibit RMA-14 presents the details of ten wholesale power sales contracts entered into by PacifiCorp since 1995. This resulted in a system net loss of

$374,577,911 on sales revenue of $98,311,650. Using an SG factor of 37.1436%, this results in a net loss of $140,841,295 for the Utah jurisdiction.

VII. CONCLUSIONS

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AS TO THE COMPANY'S WHOLESALE POWER SALES MARKET STRATEGY.

A. In the early 1990s, the Company voluntarily and deliberately undertook the risks and rewards of managing wholesale market risks. As correctly noted by Mr. Topham, business risk properly follows business decisions. Beginning in 1996, the Company made an abrupt shift in its wholesale market strategy to greatly expand its presence in the wholesale markets. At the same time, it elected to gamble by relying on short term market purchases to meet long term wholesale commitments.

The Company's wholesale power sales market strategies and activities were not necessitated by retail system needs, since at least 1995. At that time, the Company took a deliberate business gamble that resulted in a costly blunder. The risks stemming from these business decisions and ventures properly lie with the Company. Business risk follows business decisions.

My testimony highlights six post-1995 wholesale power sales contracts and found that they were ill-conceived, even at the time, and did not appropriately mitigate potential risk to PacifiCorp of changes in wholesale market prices over the term of the contracts. These contracts produced a test year net loss of

$173.0 million for the system and $64.0 million for Utah. My testimony also presented the details of ten wholesale power sales contracts entered into by PacifiCorp since 1995. This resulted in a system net loss of $374,577,911 on sales revenue of $98,311,650. Using an SG factor of 37.1436%, this results in a net loss of $140,841,295 for the Utah jurisdiction.

Q. BASED ON THE ANALYSIS DISCUSSED ABOVE, DO YOU RECOMMEND ANY ADJUSTMENTS TO THE COMPANY'S NET POWER COST FIGURES?

A. Yes. Based on my analyses, I find that the test year economic loss caused by PacifiCorp's wholesale power sales market strategy was in the range of $173.0 to $375.0 million for the system and $65.0 to $141.0 million for Utah. I propose a disallowance at a minimum of $64,208,149 (see Exhibit RMA-15). This proposed disallowance is in lieu of the proposed Company adjustment of 5.5. This is the lower boundary of the range of economic costs associated with the wholesale power sales contracts entered into by PacifiCorp since 1995.

Q. DO YOU BELIEVE THAT THIS IS A CONSERVATIVE ADJUSTMENT?

A. Yes. One could argue for much higher adjustments based on a number of different theories. For example, the figures and analysis reflected in Exhibit RMA-11 would support a much larger adjustment.

Q. PLEASE EXPLAIN.

A. For decades, the Company's retail ratepayers in Utah and other jurisdictions have borne the costs of the generation and other long-term resources of the

Company. Having borne the cost of the long-term resources during times of excess capacity, those retail ratepayers should have the first call on the resources in times of shortages and high market prices. The Company deprived its retail ratepayers of the significant value of some of these long-term resources during the current period of unprecedented market prices by accepting unreasonable levels of wholesale market risk through long-term commitments without adequate long-term resources.

Assume, for example, that the company had reserved all of its generation resources and 50% of its long-term purchased power resources to serve retail load. Under that assumption, Exhibit RMA-11 shows that only 13.09% of the company's actual test year short-term firm (STF) purchases would have been necessary to serve retail load. Under that assumption, the Company would have been required to purchase additional energy during 4127 hours (47%) of the test year. During the other 4657 hours (53%), the Company could have sold its excess generation. Using PacifiCorp's average STF purchase cost of $108.89 per Mwh and average STF sales price of $112.34 per Mwh, the Company would have thus spent $227,588,267 ($108.89/MWh x 2,090,075 MWh) on market purchases and would have received $1,324,372,216 ($112.34/MWh x 11,788,964 MWh excess available) in market revenues during the test year. The net value to retail ratepayers would have been $1,096,783,948.

One could theoretically argue for an adjustment of this magnitude. Even assuming that the company's shareholders and ratepayers should equally bear this potential value (an assumption that I do not make), the revenue requirement adjustment would be $548,391,974 million ($203,692,521 million for Utah).

The import of this example is telling. Had the Company reserved its long-term resources primarily for the benefit of its retail customers, and had it not elected to gamble to such a large extent on the short-term market, the Company's Utah revenue requirement would have been dramatically lower than the Company now claims. I believe that a net power cost adjustment of at least $64 million, and perhaps ranging as high as $203,692,521 million, is appropriate.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.