Q. Please state your name, business address and position with PacifiCorp (the Company).

A. My name is Stan Watters. My business address is 825 NE Multnomah, Portland, Oregon, 97232. My present position is Managing Director of Wholesale Energy Services.

Qualifications

Q. Please describe your education and business experience.

A. I joined the Company in 1982 and I have held various positions in engineering, finance, and wholesale prior to my current position. In my position as Managing Director of Wholesale Energy Services, I am responsible for the Company's wholesale sales and trading functions including the economic dispatch of PacifiCorp's system resources. I graduated from Oregon State University in 1981 with a Bachelor of Science in Civil Engineering.

Purpose of Testimony

Q. What is the purpose of your testimony?

A. I will respond to opposing testimony concerning certain long-term wholesale contracts executed by the Company after 1995. I address the claims of various parties that these contracts should be adjusted to comply with certain "guidelines" for revenue credit treatment apparently adopted in the early 1990s, but never followed. Specifically, my testimony responds to Division of Public Utilities' witness Rebecca Wilson's recommendation that the Commission impute $67 million in revenues on a Total Company basis, for fourteen long-term firm wholesale contracts so that these contracts "cover their embedded costs." Second, my testimony responds to Committee of Consumer Services' witness Anthony Yankel's recommendation to exclude eight long-term wholesale contracts for assertedly failing to meet the Commission's guidelines for revenue credit treatment, and to remove four additional contracts for similar reasons. Finally, my testimony responds to the Utah Association of Energy Users Intervention Group and Nucor Steel's witness Richard Anderson who recommends that the Company "absorb the economic cost associated with increased business risks resulting from its internal decisions."

My testimony shows that:

- A methodology was adopted by the Commission in the Company's last Utah general rate case (Docket No. 99-035-10) for dealing with wholesale contracts entered into by the Company during the post-1995 period. This issue should not be relitigated based on "guidelines" that were adopted nearly a decade ago and apparently have never been implemented. Rather, if the Commission determines that an adjustment is necessary, the adjustment should be calculated on the same basis as adopted by the Commission in the last rate case. For reasons described below, however, the Company does not agree that any adjustment is warranted.
- The Company acted prudently in entering into the contracts at issue, when all the circumstances known at the time are taken into account. These contracts need to be evaluated in the context of the Company's overall power supply strategy. In this regard, customers have received significant benefits over the last decade from the revenue credits provided by the Company's wholesale

activities, and from the Company's use of wholesale sales to fully utilize generating facilities until they are needed by retail customers.

- The Company's wholesale market strategy has produced a balanced and diversified resource portfolio, moderating reliance on short-term markets and leaving the Company well positioned to meet customer demands in the future.
- The strategy followed by the Company in recent years in reasonably matching its resources with sales commitments – both retail and wholesale – was a prudent one. The source of upward pressure on power costs is the extraordinary increase in wholesale prices and retail load growth, not any imprudence in the power supply strategy or its implementation by the Company.

Q. How is your testimony organized?

A. I describe the previous Commission action with respect to the contracts, including the review conducted in the Company's last general rate proceeding. My testimony then describes how the Company's wholesale activities provide benefits to retail customers. Then I discuss how the level of the Company's wholesale activities has responded to the Company's changing circumstances and conditions in the wholesale electricity markets in recent years. Focusing in particular on the power sales agreements executed after 1995, I discuss (1) the period leading up to the challenged transactions, (2) the circumstances during the 1996-98 period, and (3) the subsequent actions taken by the Company. My testimony shows that the Company's strategy of matching its resources with retail and wholesale sales was a reasonable course of action and is not the cause of the upward pressure on power costs. Rather, the increase in net power costs is driven almost entirely by the unanticipated five-fold increase in annualized wholesale prices and growth in retail load. With respect to the challenged power sales agreements in particular, my testimony shows that when evaluated in the context of the circumstances existing at the time, these agreements were prudent and provided benefits to customers.

Previous Commission Review of Challenged Contracts

Q. Were any of these contracts reviewed by the Commission in the Company's last general rate case in Utah?

A. Yes. In Docket No. 99-035-10, there was extensive discussion of wholesale contracts entered into by the Company since 1995, and the appropriate adjustment to be made to address concerns that the Company "entered into contracts that sell power for less than the cost to serve them." (Docket No. 99-035-10, Report and Order, p. 47) Ms. Wilson testified for the Division, and proposed a revenue imputation for "four intermediate term contracts and two-long-term firm contracts [that] were priced below PacifiCorp's own marginal costs." (Docket No. 99-035-10, Ex. DPU 9.0, p. 10) Ms. Wilson's proposed adjustment was based upon avoided costs that were applicable in Utah at the time the contracts were signed as the basis for calculating the revenue imputation. Mr. Yankel testified for the Committee, and made a similar proposal applicable to a greater number of contracts – twelve rather than six – and basing the calculation of the adjustment by reference to the Company's retail contracts. (Docket

No. 99-035-10, Ex. CCS-8R) The Commission's Report and Order in that proceeding includes an extensive discussion of the issue.

Q. How did the Commission resolve this issue in Docket No. 99-035-10?

A. The Commission's May 24, 2000 Order did the following:

- The Commission stated that "the Company is not required to seek Commission approval of such sales." (Order, p. 50)
- The Commission found that the appropriate measure for purposes of the revenue imputation was the "avoided cost rate that has been filed in Utah," regardless of whether more current information was available from another jurisdiction at the time the contracts were signed. (Id.)
- The Commission adopted the Division's proposed adjustment for transmission losses. (Id.)
- The Commission adopted the Division's recommended wholesale revenue imputation, which reduced the Company's revenue requirement, by $1.5 million. (Id., p. 51)

Q. Are the parties recommending a different approach in this proceeding?

A. Yes, notwithstanding the extensive testimony and discussion about these contracts and this issue in the Company's last rate case, Ms. Wilson, Mr. Yankel and Mr. Anderson are proposing an entirely different approach in this proceeding with respect to the contracts, even though the underlying issue is the same.

Q. What is the basis for the approach proposed by these parties in this case?

A. Each of these parties is recommending an adjustment based upon "guidelines" for using the revenue credit method for firm wholesale sales that was acted upon in one form or another by the Commission in the early 1990s. According to the testimony of Ms. Wilson, Mr. Yankel and Mr. Anderson, the Commission in its Phase I order in Docket No. 90-035-06, issued on December 7, 1990, adopted a proposal which provided for the filing of wholesale contracts with the Commission and required that each contract cover its "full embedded costs . . . [a]fter a short time." In a later Wholesale Contracts Task Force Report filed with the Commission in April 1993, this criteria was apparently modified, although the Commission never took any action on the proposed modification. These parties recommend, in one form or another, that the "guideline" be implemented in this proceeding, even though this approach was ignored in the Company's preceding two general rate cases since the "guideline" was "adopted."

Q. Does the Company agree that this approach should be followed in this proceeding?

A. No. The Commission already resolved this issue in the last proceeding, where a methodology was adopted after a full and complete hearing on the issues. This issue should not be re-examined based on "guidelines" that were adopted nearly a decade ago and apparently have never been implemented. The Company does not deny that in 1990 the Commission put into place guidelines related to revenue credit treatment of wholesale contracts. The Company has apparently overlooked these rather old guidelines in pretty much the same way that the Division, Commission Staff and all of the intervenors in Docket Nos. 97-035-01 and 99-035-10 overlooked the guidelines. This oversight is understandable; during the period immediately following the Commission order in Docket No. 90-035-06, the Company signed few contracts that would have required Commission approval. Twelve of the disputed contracts had start dates between 1996 and 1998, five years after the Commission's decision was issued. Now that the Commission more recently has adopted a methodology for dealing with wholesale contracts entered into by the Company during this period, any adjustment in this case should be calculated on the same basis as adopted by the Commission in the last rate case.

Q. Have you calculated the adjustment that would be made in this case using the methodology adopted by the Commission in the Company's last general rate case?

A. Yes. Rebuttal Exhibit UPL__.1R (SW-1R) shows the calculation of the adjustment for the contracts identified by Ms. Wilson, applying the methodology adopted by the Commission in Docket No. 99-035-10. Rebuttal Exhibit UPL__.1R (SW-1R) calculates the difference between test year revenue and "avoided cost revenue" for the contracts identified by Ms. Wilson and imputes additional revenue to those contracts where test year revenue is below "avoided cost revenue." "Avoided cost revenue" is calculated using the same Utah Commission-approved avoided costs method used in Docket No. 99-035-10. For the majority of the contracts, test year revenues substantially exceed "avoided cost revenues." For those contracts where test year revenues are below "avoided cost revenues," revenues are imputed for the difference. Pursuant to the order in Docket No. 99-035-10, the Company imputed wholesale revenues in its initial filing based on this methodology. Imputed revenues on Rebuttal Exhibit

UPL__.1R (SW-1R) are therefore reduced by the revenues imputed in the Company's initial filing.

Q. What is the amount of the adjustment?

A. After taking into account the $1.3 million which has already been included in the current case consistent with Docket No. 99-035-10 (Exhibit UPL__.1 (DDL-1)), the adjustment on a Total Company basis is $655,931, as shown in Rebuttal Exhibit UPL__.1R (SW-1R). For the reasons set forth below, however, the Company maintains that no adjustment is warranted, given the prudence of the Company's decisions to enter into the challenged agreements under the circumstances known at the time.

Q. Why is the amount of the adjustment essentially the same in this case as it was in the last case, even though this case includes an additional 10 contracts in the adjustment?

A. The adjustment is very close because the additional contracts have prices that are higher than the avoided cost floor price shown in Rebuttal Exhibit UPL__.1R (SW-1R).

Overview of the Company's Wholesale Strategy

Q. Can you summarize the Company's wholesale market strategy?

A. Yes. The Company has used its wholesale activities to optimize its resource system, minimize the need for rate increases, stabilize costs to retail customers and achieve a reasonable rate of return for shareholders. The Company has taken a long-term approach, focusing on fundamentals such as market access, diversification and balance. The Company's wholesale market strategy has and will continue to produce significant benefits for its customers.

Q. How have the Company's Utah customers benefited from this wholesale market strategy?

A. The revenues derived by the Company from wholesale transactions provide revenue credits, which reduce the net power costs borne by retail customers. Depending on circumstances in the wholesale market, the Company has both expanded and contracted the level of its wholesale sales to maximize benefits for customers. The Company's customers have received their share of over $1.3 billion in benefits on a Total Company basis from the Company's wholesale sales strategy during the preceding decade. Rebuttal Exhibit UPL__.2R (SW-2R) sets forth the calculation of the $1.3 billion figure.

Q. What is the basis for this estimate?

A. As described in my testimony, the Company during the 1990s acquired over 1300 MW of resources that were determined to be prudent acquisitions. Given the capacity available from those resources until they were fully needed to meet retail load, the Company had the option of either (1) making short-term wholesale sales, with lower revenues and lower benefits to customers, or (2) making longer-term sales, with correspondingly higher revenues and benefits to customers. The Company chose the latter course of action, and the incremental revenue associated with this course of action is the $1.3 billion figure.

Q. If your strategy was successful, why is the Company seeking recovery of approximately $140 million in increased net power costs in this proceeding?

A. The increase in net power costs is driven almost entirely by the unanticipated dramatic increase in wholesale prices and growth in retail load, not any imprudence in the power supply strategy or its implementation by the Company.

Since May 2000, electric utilities have been faced with extraordinary increases in the prices for electricity in the wholesale market. The average market price of purchased power included in current rates in Utah is approximately $22 per MWh. During the test period, annualized market prices are closer to five times higher. In this environment, the Company's strategy of relying on the market for short-term purchases to fill in during the "peaks" of a generally balanced load/resource situation has become very costly. The market purchases used to fill in the occasional short-term deficiency in supply are no longer priced at 20 to 30 mills, but at prices dramatically higher. Virtually every risk from a common 48 hour outage on a thermal unit to a common weather related load swing is vastly more costly today than it was in the past. These levels of cost are not currently reflected in our retail prices. Had price levels continued at historical levels, the issues raised by the parties with respect to our wholesale sales strategy would largely drop away.

Q. What do you mean by "historical levels"?

A. I am referring to the level of prices that historically prevailed in the wholesale markets in the region, and that, prior to May 2000, were expected to continue into the foreseeable future. For example, in Docket No. 99-2035-03 involving the sale of the Company's Centralia plant, Ms. Wilson filed testimony for the DPU criticizing the Company's estimates of replacement power costs, i.e., the cost of wholesale market purchases that would take the place of the Company's share of the output from Centralia. Rebuttal Exhibit UPL__.3R (SW-3R) is Ms. Wilson's Exhibit 1.6 from that proceeding, and shows several market price forecasts for the Northwest. The highest scenario produced by the Northwest Power Planning Council (NWPPC) shown on that exhibit suggests prices of $30/MWh for 2000, $33/MWh for 2001, and $36/MWh for 2002. Ms. Wilson, for her part, relied on the medium range numbers for her analysis, which are even lower: $24/MWh for 2000, $26/MWh for 2001 and $26/MWh for 2002. I should further point out that the NWPPC low projections are below PacifiCorp's low for all three of these years. Had projections like those shown in Rebuttal Exhibit UPL__.3R (SW-3R) actually materialized during the test period, the Company would not be asking for approximately $140 million in increased net power costs, and parties would likely not be assailing the Company's wholesale sales strategy as imprudent.

Q. How has load growth contributed to the need for higher rates?

A. As will be described in more detail later in my testimony, our power supply strategy was designed to match loads and resources, thereby minimizing the extent of the Company's exposure to purchases on the wholesale market. In other words, the intermediate- to long-term contracts signed during the 1996-98 period were timed to expire at about the time that the Company's resources were expected to become fully necessary to serve retail load. As a result of load growth the Company's resources were needed earlier than anticipated. Of course, without the significant increase in wholesale prices, this slight mismatch between projected and realized load and resources would have been inconsequential.

Combined with conditions in the wholesale markets, however, the failure to achieve a precise matching of loads and resources – an impossible feat under the best of circumstance – has exaggerated consequences. On the basis of the information known at the time the challenged contracts were executed, however, the Company's strategy was a reasonable one and was prudently implemented.

Q. The testimony of Ms. Wilson, Mr. Yankel and Mr. Anderson claim that the level of the Company's wholesale activities have shifted dramatically, particularly during the period after 1995. Could you please describe the Company's strategy with respect to wholesale sales?

A. Yes. Wholesale sales increase the resource efficiency of the Company's generating and transmission resources. It is extremely difficult to time the acquisition of resources to match precisely with retail load requirements. The availability of wholesale sales allows purchases of resources ahead of retail requirements to take advantage of opportunities to acquire resources on favorable terms. The Company had opportunities in the early to mid-1990s to acquire new resources on very favorable terms, as discussed later in my testimony. I do not deny that the Company has expanded and contracted the level of its wholesale sales to maximize benefits for customers.

Q. Please explain.

A. The graphs in Rebuttal Exhibit UPL__.4R (SW-4R) show the Company's wholesale sales and purchases volumes during the ten-year period from 1991 through 2000. As shown on the exhibit, volumes climbed during the 1996-98 period as the Company had available to it generating resources that were not fully utilized serving retail load. Toward the end of the ten-year period, sales declined as the Company's long-term and intermediate-term contracts began terminating to correspond with when the resources were expected to be needed to serve retail loads. As also shown on the exhibit, sales and purchases volumes climbed during the 1996-98 period as the Company took advantage of the favorable conditions in the wholesale market during that period. Toward the end of the ten-year period, purchases declined as market conditions and wholesale activity changed, although short-term market purchases still represent a small portion of the Company's system requirements. Net short-term purchases are approximately 5% of system requirements during the test period.

Q. Ms. Wilson, Mr. Yankel and Mr. Anderson claim that since 1995, the Company has engaged in a "risky strategy" or a "flawed business strategy" by meeting its long-term wholesale sales obligations with short-term purchases. How well did the Company match its short- versus long-term wholesale sales with the Company's actual available resources during the 1996-2000 period?

A. The Company actually did a very good job in matching its long-term wholesale sales decisions with its available long-term resources. Table 1 below shows that the Company's net short-term purchases comprised a relatively constant percentage of the overall system requirements. This means that the Company was not being overly aggressive in the wholesale market and exposing customers to unreasonable market price risk.

Table 1
PacifiCorp 1996-2000
Net Short-Term Purchases as a Percentage of System Requirements

Year	System (MWh)	Net Short Term Purchases (MWh)	% of System Requirements
1996	79.0	0.9	1.1
1997	109.5	1.8	1.6
1998	97.4	2.3	2.4
1999	87.1	1.7	2.0
2000	82.7	5.4	6.5

Q. You stated that the Company matched its short-term sales and purchases fairly well except in the year 2000. What happened in the year 2000 that led to a such a change in the net short-term purchase requirement?

A. Several events occurred in 2000 that contributed to this change. First, the Centralia plant was sold to TransAlta in May of 2000, a transaction that was approved by this Commission as well as the other state commissions that regulate the Company. This sale, net of the associated replacement power contract with TransAlta, eliminated approximately 3.1 million MWh's from the Company's long-term resource portfolio in the year 2000. In addition, the Company experienced a catastrophic failure at its Hunter unit #1 plant in late November – which contributed approximately another 330,000 MWh's of short-term purchase requirement in 2000 – as well as the second worst water year on record – which added another 500,000 MWh's of short-term purchase requirement in 2000. Finally, the Company's retail load growth in 2000 added additional short-term purchasing requirements. Absent these impacts, the Company's net market purchases would have been less than 2.0%. Even with all of these impacts to the Company's long-term resource portfolio, the Company's net short-term purchase requirement in 2000 represented a fairly small amount – about 6.5% - of the Company's system requirements. It should be noted that the test period excludes the Hunter 1 outage and poor hydro impacts. Therefore, in addition to load growth, the Centralia sale was the primary cause of the increase in net short-term purchases during the test period.

Q. Ms. Wilson claims that in following its wholesale sales strategy, "PacifiCorp accepted a risk for a strategy that has backfired" and that shareholders should therefore bear most of the cost of the increase in net power cost identified in this proceeding. Do you agree with this approach?

A. No. The Company's strategy was prudent and has produced considerable benefits for customers. For the reasons stated in my testimony, I do not believe that such a finding can be made with respect to the Company's wholesale sales strategy. Moreover, the position Ms. Wilson is taking in this proceeding seems to throw onto shareholders the risks that she was assigning, in part, to customers in the Company's Centralia proceeding.

Q. Please explain.

A. In the case where the Commission approved the sale of the Centralia plant, Docket No. 99-2035-03, Ms. Wilson performed an analysis to determine the level of gain that Utah customers would need to receive from the sale in order to be "compensated for the risk that replacement cost will be higher than the cost of keeping Centralia." (DPU 1.0 (RLW), p. 14) In other words, for purposes of her analysis, customers would assume the risk of increases in the cost of replacement power, and would need to be compensated for that risk by receiving a large portion of the gain from the sale. The Commission agreed that "the important remaining risk occasioned by the sale is the going-forward risk of high-cost replacement power." (Order, p. 17) Based on this risk analysis, the Commission allocated 95% of the gain to ratepayers. (Id.) It is entirely inconsistent for the Division to suggest in this proceeding that the Company's shareholders are required to bear the risk of higher wholesale power prices, at least as to the extent of higher costs associated with Centralia replacement power. From the testimony and decision in Docket No. 99-2035-03, it appears that the risk of higher cost of replacement power has been largely allocated to customers, for which they have been compensated by the allocation of the gain in the Centralia proceeding.

Q. Have you calculated how much of the increased net power cost in this case is attributable to Centralia replacement power costs?

A. Yes. Rebuttal Exhibit UPL__.5R (SW-5R) shows that on a Total Company basis, the net additional purchased power expense associated with Centralia replacement power in excess of the cost of Centralia output is approximately $207 million. The Utah share of this figure is about $75 million. Therefore, if the Commission adopts adjustments proposed by the DPU, CCS, UAE, or UIEC, related to imputed revenues on wholesale sales purported to be served from short-term purchases or purported losses on short-term purchases, those adjustments should be reduced by Utah customers' $75 million share of Centralia replacement power costs.

Circumstances Prior to 1996

Q. What were the circumstances in the wholesale markets during the period preceding 1996?

A. With the implementation of the Energy Policy Act of 1992, competition in the wholesale markets increased. Two new categories of market entrants – the Exempt Wholesale Generator, or EWG, and the merchant marketer – were introduced, and wholesale transmission became more readily accessible. During this period, demand side management (DSM) programs began to receive cost recovery changes that put DSM measures on a more equal footing with supply-side programs. In addition, the Trojan nuclear power plant closed in 1993, reducing regional power supplies by 1100 MW. At about the same time, the Bonneville Power Administration increased rates, raising both commodity and transmission charges.

Q. Please describe the Company's activities during this period.

A. The Company was presented with several opportunities to acquire new resources on very favorable terms. In September 1990, the Company entered into four agreements associated with the purchase of Cholla Unit 4, a 380-MW unit, from Arizona Public Service (APS), including a seasonal exchange with APS. In addition to acquiring a large increment of economic generation, the transaction also provided the Company with 350 MWs of flexible transmission rights. These transmission rights gave PacifiCorp and its customers access to new markets that provided an additional option to purchase more economical resources or sell surpluses on more favorable terms.

This was followed in April 1992 by the acquisition of Craig Units 1 & 2 and Hayden Units 1 & 2 – for a total of 250 MW – with a partial sale back to Public Service of Colorado. Like the purchase of Cholla unit 4, the purchase of the Craig and Hayden resources provided the Company with additional transmission rights and greater access to additional purchase and sale opportunities. During the summer of 1992, the Company signed an agreement to develop the 50-MW James River Cogeneration Project.

In October 1993, the Company entered into a series of agreements to develop the Hermiston Cogeneration Project, a 474-MW natural-gas-fired project that is 50 percent owned by the Company with the remaining 50 percent purchased by the Company through a long-term contract. The Company also entered into a winter capacity purchase of 422 MW from Southern California Edison for ten years, beginning with winter season 1993, to satisfy peaking requirements, at a cost lower than construction of gas turbines.

Other resource acquisitions initiated during this period include development of the Foote Creek wind project in Wyoming; undertaking turbine upgrades throughout PacifiCorp's system increasing generation by about 220 MW; purchasing 100 MW for 1993-95 and 50 MW for 1996-97 from Deseret Generation & Transmission Cooperative; and executing a new 20-year peaking contract with BPA for 1100 MW. It should be emphasized that all physical resource acquisitions mentioned above have been included in rate base in cases before this Commission. Under present market conditions, these resources are now of significant value to PacifiCorp's customers.

Circumstances During the 1996-98 Period

Q. Mr. Anderson claims that after 1995, the Company's wholesale marketing activities "were not geared primarily toward balancing retail loads and resources." Mr. Yankel states that "PacifiCorp's approach to the wholesale market had greatly changed" during this time period. What were the circumstances in the wholesale markets during the 1996-98 period?

A. The wholesale markets during this period were marked by strong competition, with very heavy sales and purchasing volumes. With the number of new entrants into the wholesale markets, the expansion of new markets and the establishment of new trading hubs, there were many participants and market prices declined to the lowest levels in history and resulting margins on sales became extremely narrow. BPA was forced to release many of its customers to shop for alternative supplies in this low-priced wholesale market. The market was thought to be overbuilt, and the surplus in the western region was expected to continue for several years.

Q. What other circumstances existed at the time?

A. Hydro conditions were normal to heavy during most of this period. In addition, with the issuance of Order 888/889 by FERC, wholesale market participants were provided with open access to the transmission system, thereby increasing liquidity and market activity. At the same time, a NYMEX futures market was established for the California-Oregon Border (COB) and Palo Verde (PV) markets in anticipation of heavier financial volumes and trading. Also during this period

Dow Jones began publishing in the Wall Street Journal daily market price indices for COB, Palo Verde, and later Mid Columbia and Four Corners.

Q. How was the situation viewed by PacifiCorp during the 1996-98 period?

A. As discussed by Mr. Hedman, PacifiCorp did not need peaking capacity under medium load growth until 2004, with energy requirements necessary in 2010.

Q. What were the conclusions of RAMPP-4 as far as prices during this period?

A. As discussed by Mr. Hedman, the Company projected the price of market based power to be approximately $ 25 per MWh (in real 1996 dollars) in 2001. Short-term firm power was viewed as a cheaper alternative to simple cycle combustion turbine (SCCT) and CCCT additions.

Q. Given this analysis, what was PacifiCorp's strategy with respect to wholesale sales during the 1996-98 period?

A. PacifiCorp entered into intermediate term sales during this period. These sales were timed to terminate in the years that the resources were likely to be needed by retail customers. Accordingly, the sales were typically three-to-five years in length, and most terminate in the 2000 to 2002 period. These were system sales backed by the overall portfolio of resources, including market purchases. In a later section of my testimony, I present the analysis of the particular contracts challenged by Ms. Wilson, Mr. Yankel and Mr. Anderson in this proceeding.

Q. Was PacifiCorp also making market purchases during this period?

A. Yes. PacifiCorp was purchasing in the short-term firm markets during this period to support overall requirements of the system portfolio. These purchases were for the benefit of the system, and not one particular group of customers. As stated earlier in my testimony, overall the Company's net short-term purchases were a small part of the Company's total resources. These purchases were used to fill in resource deficiencies during times of peak usage as well as to make short-term sales to optimize the Company's system.

Q. Apart from short-term firm purchases, were there intermediate-term resource acquisitions during this period that hedged some of the sales in question?

A. Yes. PacifiCorp also took advantage of opportunities to procure surplus resources from other re-sellers, Deseret Generation & Transmission Cooperative (Deseret G&T) and Black Hills Power & Light (Black Hills). In the case of Deseret G&T, it sold PacifiCorp its surplus, subject to its marketing activities, for a five-year period. Under the arrangement, PacifiCorp and Deseret G&T shared in the benefit of the market price over a price threshold. In the case of Black Hills, it sold PacifiCorp its surplus resources for a six-year period from the Neil Simpson II unit. Under this arrangement, PacifiCorp and Black Hills shared in the benefits of market prices over a price threshold.

Circumstances After 1998

Q. How did circumstances change in the wholesale markets after 1998?

A. A combination of circumstances dramatically changed the environment in the western wholesale markets after 1998. The focus of these markets became much more short-term; long-term product liquidity was dramatically reduced due to regulatory and legislative uncertainty about the future structure of the industry and the restructuring initiatives that were being pursued in various Western states.

There was also increased credit and market price uncertainty following the incidents of the summer of 1998 in the Eastern U.S. trading markets.

The evolution of the short-term markets was accelerated by the California PX and ISO arrangements, which also affected long-term market products and liquidity. A related circumstance was the change of control of California resources during this period, which led to uncoordinated outages and shortage situations within California and the WSCC. Finally, in the Northwest, the Biological Opinions of 1998 and 2000 reduced hydro capabilities for the region during summer seasons. Another operational change was the adjustment of WSCC transmission ratings, which reduced transmission capabilities between key western and eastern markets (and correspondingly reduced PacifiCorp's system seasonal diversity advantages).

Q. How did PacifiCorp's regulated wholesale activities change during this period?

A. PacifiCorp reduced its trading and marketing activities in response to the changes in market conditions. PacifiCorp continued to optimize its system with a focus on near-term markets, and covered peak requirements through short-term market purchases. PacifiCorp also restructured some out-of-market QF contracts during this period. Short-term sales/purchases with California investor-owned utilities were replaced with California ISO and PX market activity. This activity was reduced during the summer of 2000, as creditworthiness concerns increased, resulting in reduced liquidity and market opportunity for the Company.

The Prudence of the Challenged Wholesale Contracts

Q. Which wholesale contracts are being challenged in this proceeding?

A. Ms. Wilson is challenging all 14 contracts listed in Exhibit SW-1. Apart from Ms. Wilson's proposed adjustments, Mr. Yankel is proposing an adjustment to eight of these agreements as being contrary to the Commission's "guidelines" (Clark Sale, Clark-FiberWeb, Clark-WaferTech, Cowlitz BHP, Hinson, Okanogan, PNGC and Springfield II), and is proposing adjustments to four others (Deseret Supplemental, WAPA I & II, and Citizens Power) on other grounds. Mr. Anderson, for his part, is proposing an adjustment based on five of these agreements (Springfield II, Hinson, Clark-FiberWeb, Clark-WaferTech, and Cowlitz-BHP), and adds a sixth transaction (the San Diego Gas & Electric wholesale sale). In addition, Mr. Anderson also discusses four other agreements, all of which are included in Ms. Wilson's list of 14 contracts (Clark Sale, PNGC, Deseret Supplemental, and Okanogan).

Q. Which of these proposed adjustments will you be discussing in your testimony?

A. I will respond to all of these proposed adjustments, except for Mr. Yankel's proposed adjustments for the WAPA I & II sales and the Deseret Supplemental agreements, which are being addressed by Mr. Widmer. My presentation includes an avoided cost analysis with respect to the challenged contracts, as well as a discussion of the Company's analysis of loads and resources at the time.

Q. What were the Company's avoided costs during the period these contracts were executed?

A. The avoided costs based on RAMPP-4, filed in February 1997 are shown on Rebuttal Exhibit UPL__.6R (SW-6R), which I present later in my testimony.

Q. Were these the avoided cost estimates used to evaluate wholesale contracts during the period when the challenged contracts were put into place?

A. Yes. These were the avoided cost estimates used by the Company to evaluate wholesale contracts during this period. Other estimates that were approved and in effect in Utah during this period were based on an earlier version of RAMPP and thus were out of date.

Q. Please explain the avoided costs shown above.

A. The Company calculates its avoided costs for two periods – the period of resource sufficiency (1996-2003) and the deficit period. For the sufficiency period, avoided costs are the decremental cost of the Company's next unit of generation from its embedded system. For the deficit period, avoided costs are based on the cost of a combined cycle generation unit.

Q. Why is it appropriate to use avoided costs to determine the prudence of wholesale sales transactions?

A. Avoided cost represents the Company's incremental cost of serving new wholesale sales. As long as the sales price is higher than avoided cost, the sale provides a benefit, a contribution to fixed costs.

Q. How do the prices under the contracts challenged by Ms. Wilson compare with the Company's estimates of avoided costs at the time?

A. Twelve of the fourteen contracts were put into place during 1996 and early 1998 and should be compared against these avoided costs. In every case, the total revenue generated by the contract prices obtained by the Company in these sales exceeded the Company's avoided costs through the test period. Rebuttal Exhibit

UPL__.6R (SW-6R)shows the contract prices of these agreements compared to the Company's concurrent estimate of avoided costs over the contract period.

Q. Ms. Wilson included Black Hills Storage as one of the contract that should be adjusted. Is this contract different?

A. Yes. The Black Hills Storage contract is, as the name implies, a storage contract rather than a sales agreement. As such, the contract is not comparable to either the sale or purchase of energy. I therefore excluded this contract from our analysis in Rebuttal Exhibit UPL__.6R (SW-6R), and no adjustment for it is justified.

Q. What does Rebuttal Exhibit UPL__.6R (SW-6R) show?

A. Rebuttal Exhibit UPL__.6R (SW-6R) shows the Company's actual contract revenue from twelve of the fourteen contract that Ms. Wilson singled out for special revenue treatment. The first column shows the avoided costs that the Company filed in February 1997. In the next columns are the actual revenues for each of the five years from 1996 to 2000. By comparing actual revenue to the filed avoided costs, we can determine which of the contracts made a contribution to fixed costs and thereby benefited ratepayers.

Q. What do you conclude from Rebuttal Exhibit UPL__.6R (SW-6R)?

A. Rebuttal Exhibit UPL__.6R (SW-6R) shows that every single contract has provided a positive benefit to ratepayers through the test period, and the total benefit to ratepayers from these contracts is $161 million.

Q. What about the other two contracts challenged by Ms. Wilson?

A. The remaining two contracts WAPA Sale and Redding Sale were put into place in 1991 and 1994 and have prices of over $30/MWh. Therefore, the prices are above the avoided cost floor shown on Rebuttal Exhibit UPL__.6R (SW-6R).

Q. How do you respond to Mr. Yankel's proposed adjustment to the Citizens Power contract?

A. Mr. Yankel's analysis of this contract ignores some very important features. First, as Mr. Yankel acknowledges, deliveries under the Citizens Power contract are only during certain hours of the day. But within certain requirements, the Company determines when the power is to be delivered (i.e., the Company determined the daily schedule and basically has a requirement to deliver 78% of the time, which means that the Company can deliver 3 out of 4 days and determine which days it will deliver power). Second, the primary points of delivery are mainly in Wyoming and Colorado, which in general are lower priced markets than the main hubs in the WSCC because of the supply/demand situation in these transmission constrained areas. Third, the sales are made at plant buses in Colorado or very close to the Company's plants in Wyoming, thereby avoiding losses and transmission expense. Taking these factors into account, the Company receives a very good price compared to our alternatives. No adjustment is justified.

Q. How do you respond to Mr. Anderson's proposed adjustment to the San Diego Gas & Electric contract?

A. The Company believes the same avoided cost test should be used to test the prudence of the San Diego Gas & Electric contract as that ordered in Docket

No. 99-035-10, which is the methodology used to prepare Rebuttal Exhibit UPL__.1R (SW-1R). Using this methodology, normalized revenue was $14.4 million; imputed revenue would be $15.0 million for a revenue adjustment of $540,813. This calculation is shown in Rebuttal Exhibit UPL__.7R (SW-7R).

Summary

Q. Please summarize the Company's position with respect to the wholesale contracts being challenged by Ms Wilson, Mr. Yankel and Mr. Anderson.

A. As I have described above, the Company's wholesale strategy was prudent based upon the information that was available at the time the transactions were undertaken and the Company's reasonable expectations regarding future market conditions. The problem was not the Company's wholesale strategy, but rather the unexpected and devastating increase in market prices that began in May of 2000 and the retail load growth since these contracts were signed.

As discussed above, these particular contracts had prices that were very much in line with market prices at the time the contracts were executed. Moreover, these contracts have a limited duration of three-to-five years, and thus enabled the Company to produce benefits for customers during the intervening period until the underlying resources were expected to be fully utilized to serve the Company's retail load.

The Company performed the proper analysis at the time the agreements were executed by comparing the prices under these agreements with estimated avoided costs over the term of the agreements. In each and every case, the benefits received by the Company under the agreements were greater than avoided cost estimates at the time over the applicable time period. The agreements were thus prudent when evaluated under the circumstances as known to the Company at that time. Therefore, the Commission should not adopt the adjustments to these agreements as proposed by Ms. Wilson, Mr. Yankel and Mr. Anderson.

Q. Do you have any other concerns with the approach used by Ms Wilson, Mr. Yankel and Mr. Anderson?

A. Yes. Apart from their "hindsight" analysis of challenging agreements based on what we know *today* about market prices, their approach is selective and simplistic. They identify a particular slice of wholesale activities – short- to medium-term sales – and evaluate these agreements in isolation (using hindsight "analysis") without considering the Company's overall strategy and how these agreements fit into that strategy. The proper inquiry is whether the Company's overall strategy was reasonable, and properly implemented. As discussed earlier in my testimony, the Company pursued a prudent course of action, taking into account the overall resources and loads of the Company, in entering into these short- to medium-term sales agreements which expire when the Company's reserves are required to serve retail load.

Under the approach advocated by these witnesses, these agreements can simply be separated out and priced as though the Company were making purchases on the market to fulfill its obligations under the agreements. In other words, these witnesses claim that these contracts are causing the Company to incur higher power costs to fulfill the contract obligations. As shown earlier in my testimony, however, the Company has purchased a very small amount of short-term power from the market. The real cause of the increase in net short-term purchases during the test period was not to serve these wholesale obligations, but arose from the sale of the Centralia power plant, and retail load growth. The simplistic analyses offered by these witnesses ignore the challenges associated with managing an entire power supply portfolio. The Company's actions were reasonable and prudent when evaluated according to the circumstances that existed at the time, and that is the relevant inquiry.

Q. Does this conclude your testimony?

A. Yes.