

Redacted

Before the
PUBLIC SERVICE COMMISSION OF UTAH
Docket No. 01-035-01

PACIFICORP

Direct Testimony of

Michael Gorman

On behalf of

Utah Industrial Energy Consumers

Project 7518
June 2001



BRUBAKER & ASSOCIATES, INC.
ST. LOUIS, MO 63141-2000

**Before the
Public Service Commission of Utah
Docket No. 01-035-01**

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Direct Testimony of Michael Gorman

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 **A Michael Gorman; my business address is 1215 Fern Ridge Parkway, Suite 208;**
3 **St. Louis, MO 63141-2000.**

4 **Q WHAT IS YOUR OCCUPATION?**

5 **A I am a consultant in the field of public utility regulation with Brubaker & Associates,**
6 **Inc., energy, economic and regulatory consultants.**

7 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
8 **EXPERIENCE.**

9 **A These are set forth in Appendix A of my testimony.**

10 **Q WHO ARE YOU TESTIFYING IN THIS PROCEEDING?**

11 **A I am testifying on behalf of the Utah Industrial Energy Consumers (UIEC). This is a**
12 **group of large industrial companies that purchase substantial amounts of electricity**
13 **from PacifiCorp (PacifiCorp or Company).**

1 **Q WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS**
2 **PROCEEDING?**

3 A I recommend an adjustment to PacifiCorp's Utah jurisdictional income tax expense.
4 PacifiCorp's Utah jurisdictional income tax expense should be limited to the expense
5 which PacifiCorp will actually incur during the period rates will be in effect.

6 **Q WHY SHOULD PACIFICORP'S UTAH JURISDICTIONAL INCOME TAX EXPENSE**
7 **BE LIMITED TO ONLY THE INCOME TAX IT WILL LIKELY PAY?**

8 A PacifiCorp's operating expenses should be limited to its actual cost of service that is
9 known and measurable. If expenses are inflated or if expenses are included in its
10 cost of service that it will not actually incur, PacifiCorp's cost of service and rates will
11 be unnecessarily increased and would not be just and reasonable. PacifiCorp should
12 be allowed to recover its reasonable and actual cost of service, but nothing more.

13 **Q WHAT EVIDENCE DO YOU HAVE THAT PACIFICORP HAS OVERSTATED THE**
14 **INCOME TAX EXPENSE WHICH IT WILL ACTUALLY INCUR DURING THE**
15 **PERIOD THAT RATES WILL BE IN EFFECT?**

16 A In its confidential response to the Utah Industrial Energy Consumers' (UIEC) Data
17 Request 3.8, Scottish Power estimated that it would produce between [REDACTED]
18 [REDACTED] per year of income tax savings. This income tax savings is produced
19 by its corporate structure and merger with PacifiCorp, which minimizes income taxes
20 in the United States, and moves taxable income to the United Kingdom. This income
21 tax savings is produced because of the way Scottish Power has funded and holds its
22 investment in PacifiCorp.

1 In data request UIEC, Ninth Set of Data Request of PacifiCorp, issued
2 May 16, 2001, UIEC asked PacifiCorp to provide a copy of its actual federal and state
3 income tax return, or a copy of the return of an affiliate company that is filing an
4 income tax return on PacifiCorp's behalf. We have not yet received a response to
5 this request, therefore we have not been able to determine whether or not
6 PacifiCorp's estimated income tax expense as included in its filing, reasonably
7 represents the income tax it incurred during the operating year or will incur during the
8 period that rates will be in effect. I expect to receive a response to this data request
9 before hearings, and I plan to present a more detailed analysis of this tax expense
10 issue at that time.

11 If PacifiCorp cannot demonstrate that it will incur income taxes at the level it
12 has reflected in its filing, then at a minimum, the Commission should adjust its income
13 tax expense for the Utah Jurisdictional Allocation of the Company's estimated income
14 tax savings as a result of the merger. Using Scottish Power's estimate of [REDACTED]
15 [REDACTED] per year of tax savings, and a dollar to pound conversion factor of 1.4336 US
16 \$/Pound¹ produces a expected annual U.S. tax savings of [REDACTED]. I created a
17 Utah allocation of this total tax savings using a Utah total rate base allocator of 36%.²

18 If PacifiCorp fails to show its actual tax expense during the operating year,
19 and can provide reasonable assurance that the additional tax expense related to its
20 requested increase in revenues, will actually be paid to the federal and state
21 governments, then PacifiCorp's cost of service should be reduced by [REDACTED]
22 [REDACTED] to reflect the expected lower income tax cost estimated by
23 Scottish Power.

1 Q WHAT IS THE AFFECT OF INCLUDING INCOME TAX EXPENSE THAT
2 OVERSTATES PACIFICORP'S ACTUAL TAX OBLIGATION DURING THE
3 PERIOD RATES WILL BE IN EFFECT?

4 A The effect is that customers will be paying rates which will provide PacifiCorp with
5 more than fair compensation. The after-tax operating income as identified in
6 PacifiCorp's filing, would be overstated, because the income tax expense it includes
7 in its filing would not reflect the expense that PacifiCorp will actually be required to
8 pay to the federal and state governments. As a result, the return on common equity
9 produced by the rates the Commission sets in this proceeding will provide PacifiCorp
10 with a return on common equity which is much higher than that found appropriate by
11 the Utah Public Service Commission.

12 As an example, if PaciCorp is awarded an 11% return on equity, with a
13 generic tax gross-up factor of 1.6X, rates will be set to charge PacifiCorp's customers
14 a pre-tax return on common equity of 17.6% (11% x 1.61). If PacifiCorp incurs the tax
15 liability as reflected in rates, 6.6% of this return will ultimately be paid to the
16 government as income taxes, and 11% will remain for PacifiCorp to compensate its
17 investors. On the other hand, if PacifiCorp's rates are set to recover a pre-tax return
18 of 17.6%, and the Company does not incur an income tax expense, then the entire
19 17.6% return will flow through to PacifiCorp's equity holders. Setting rates to provide
20 a return on equity of 17.6%, when the Commission finds a fair return on equity to be
21 11%, results in a windfall to shareholders and rates which are not just and
22 reasonable.

¹ St. Louis Federal Reserve Bank, average month September 2000.

² Utah rate base, \$2.56 billion, total rate base \$7.09 billion, Exhibit UP&L-(DDL-1), Page 2.2.

1 Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

2 A Yes.

Qualifications of Michael Gorman

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Michael P. Gorman. My business mailing address is P. O. Box 412000, 1215 Fern
3 Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

4 **Q PLEASE STATE YOUR OCCUPATION.**

5 A I am a consultant in the field of public utility regulation with Brubaker & Associates,
6 Inc., energy, economic and regulatory consultants.

7 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK
8 EXPERIENCE.**

9 A In 1983 I received a Bachelors of Science Degree in Electrical Engineering from
10 Southern Illinois University, and in 1986, I received a Masters Degree in Business
11 Administration with a concentration in Finance from the University of Illinois at
12 Springfield. I have also completed several graduate level economics courses.

13 In August of 1983, I accepted an analyst position with the Illinois Commerce
14 Commission (ICC). In this position, I performed a variety of analyses for both formal
15 and informal investigations before the ICC, including: marginal cost of energy, central
16 dispatch, avoided cost of energy, annual system production costs, and working
17 capital. In October of 1986, I was promoted to the position of Senior Analyst. In this
18 position, I assumed the additional responsibilities of technical leader on projects, and
19 my areas of responsibility were expanded to include utility financial modeling and
20 financial analyses.

21 In 1987, I was promoted to Director of the Financial Analysis Department. In
22 this position, I was responsible for all financial analyses conducted by the staff.

1 Among other things, I conducted analyses and sponsored testimony before the ICC
2 on rate of return, financial integrity, financial modeling and related issues. I also
3 supervised the development of all Staff analyses and testimony on these same
4 issues. In addition, I supervised the Staff's review and recommendations to the
5 Commission concerning utility plans to issue debt and equity securities.

6 In August of 1989, I accepted a position with Merrill-Lynch as a financial
7 consultant. After receiving all required securities licenses, I worked with individual
8 investors and small businesses in evaluating and selecting investments suitable to
9 their requirements.

10 In September of 1990, I accepted a position with Drazen-Brubaker &
11 Associates, Inc. In April, 1995 the firm of Brubaker & Associates, Inc. (BAI) was
12 formed. It includes most of the former DBA principals and Staff. Since 1990, I have
13 performed various analyses and sponsored testimony on cost of capital, cost/benefits
14 of utility mergers and acquisitions, utility reorganizations, level of operating expenses
15 and rate base, cost of service studies, and analyses relating industrial jobs and
16 economic development. I also participated in a study used to revise the financial
17 policy for the municipal utility in Kansas City, Kansas.

18 At BAI, I also have extensive experience working with large energy users to
19 distribute and critically evaluate responses to requests for proposals (RFPs) for
20 electric, steam, and gas energy supply from competitive energy suppliers. These
21 analyses include the evaluation of gas supply and delivery charges, cogeneration
22 and/or combined cycle unit feasibility studies, and the evaluation of third-party
23 asset/supply management agreements. I have also analyzed commodity pricing
24 indices and forward pricing methods for third party supply agreements. Continuing, I
25 have also conducted regional electric market price forecasts.

1 In addition to our main office in St. Louis, the firm also has branch offices in
2 Kerrville, Texas; Plano, Texas; Denver, Colorado; and Chicago, Illinois.

3 **Q HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?**

4 **A**Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of
5 service and other issues before the regulatory commissions in Arizona, Delaware,
6 Georgia, Illinois, Indiana, Michigan, Missouri, New Mexico, Oklahoma, Tennessee,
7 Texas, Vermont, West Virginia and Wisconsin. I have also sponsored testimony
8 before the Board of Public Utilities in Kansas City, Kansas; presented rate setting
9 position reports to the regulatory board of the municipal utility in Austin, Texas, and
10 Salt River Project, Arizona, on behalf of industrial customers; and negotiated rate
11 disputes for industrial customers of the Municipal Electric Authority of Georgia in the
12 LaGrange, Georgia district.

13 **Q PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR ORGANIZA-**
14 **TIONS TO WHICH YOU BELONG.**

15 **A**I earned the designation of Chartered Financial Analyst (CFA) from the Association
16 for Investment Management and Research (AIMR). The CFA charter was awarded
17 after successfully completing three examinations which covered the subject areas of
18 financial accounting, economics, fixed income and equity valuation and professional
19 and ethical conduct. I am a member of AIMR's Financial Analyst Society.