Q. Please state your name, business address and present position with PacifiCorp dba Utah Power & Light Company (the Company).

A. My name is D. Douglas Larson. My business address is Suite 2300, 201 South Main Street, Salt Lake City, Utah, 84111. My present position is Vice President, Regulation.

Qualifications

Q. Briefly describe your educational and professional background.

A. I graduated from Brigham Young University with a Bachelor of Science Degree in Accounting. In addition, I have also attended various educational, professional and electric industry related seminars during my career. I am currently a member of the board of directors of the Intermountain Electric Association, Vice President of the Utah Foundation, and I am a licensed CPA in the State of Utah. I joined the Company in 1981 in the Financial Accounting Department and have held various accounting and regulatory-related positions prior to assuming my current position.

Q. What are your responsibilities as Vice President of Regulation?

A. I am responsible for the development and execution of the Company's regulatory policy across the six states in which the Company does business. This includes management of regulatory proceedings in each of the six states, including revenue requirement, cost-of-service, rate design and all other proposed changes to the Company's tariffs. In addition, I have responsibility for developing regulatory policy on issues that the commissions must address and making recommendations to management on policy decisions.

Purpose and Summary of Testimony

Q. What is the purpose of your testimony?

A. I will explain why PacifiCorp does not believe it can offer US Magnesium LLC (US Mag) a ten-year “special economic incentive contract” without disadvantaging its other Utah customers. PacifiCorp is firmly committed to offering US Mag the best prices that it can offer based on both the cost to provide service to US Mag and on the value of any services that US Mag can offer back to the Company for the benefit of our customers. My testimony will be focused in four areas: (1) I will provide some historical context for the development of the existing arrangements with US Mag and describe the changed circumstances that now make it inappropriate to continue that type of arrangement; (2) I will explain the inherent inequities to other customers, created by offering US Mag electricity prices that are not available to other PacifiCorp customers and that are not based on sound, cost-based regulatory principles; (3) I will show that in seeking to obtain the capital investment it desires to improve its business operations, US Mag has at least partly focused on obtaining subsidies from other Utah electric customers; and (4) I will explain why the 10-year contract term proposed by US Mag witness Roger Swenson is not in the public interest.

In addition to the foregoing, I will also introduce the other PacifiCorp witnesses who will be providing testimony in this docket.

Historical Context

Q. Please describe PacifiCorp's responsibilities to its customers as a regulated public utility.

A. PacifiCorp has the responsibility to provide all of its customers with safe and reliable electric service at just and reasonable prices. As a regulated utility, "just and reasonable prices" are established by the Public Service Commission to recover the Company's prudently incurred cost of service, which includes a reasonable return on shareholder investment. In every rate proceeding, PacifiCorp files cost of service studies and rate design proposals with the Commission that are designed to allocate the costs that are required to provide electric service to that Customer or Customer Group. The objective of these studies is to ensure that all customers pay for their proportionate share of the costs incurred by the Company to serve them.

Q. Please describe the nature of the contract that first provided electric service to US Mag and its predecessors?

A. The first electric service agreement with US Mag was entered into pursuant to a Commission order dated April 19, 1968. This was a contract to provide long-term interruptible service at discounted prices. In addition to the service provided under the contract, US Mag had 40 MW of self-generation available to continue plant operations during periods of interruption.

Q. Was that first US Mag contract priced in accordance with the cost of service principles that you have previously described?

A. Yes. The 1968 contract was designed to provide benefits to both US Mag and

PacifiCorp's then-existing customers. Those benefits resulted from the Company being in a surplus generating capacity situation at that time. In a surplus capacity situation, a utility's existing customers who are paying their full cost of service will benefit when a new load can be added to the system at a price that covers the incremental cost to serve that load and makes a contribution to the recovery of fixed costs. In 1968, existing customers were better off with the new US Mag load, even at discounted prices to full cost of service, because they paid less for fixed cost recovery than they would have otherwise paid. At that time, the US Mag contract rate allowed PacifiCorp to recover the cost of providing interruptible service to US Mag, while providing rate benefits to its other customers. Consistent with this view, during the 1968 proceeding, Company witnesses indicated that the US Mag contract would allow better loading and use of facilities, resulting in lower rates to customers as a whole.

Q. Have there been more recent studies that have supported the principles embodied in the 1968 US Mag agreement?

A. Yes. The "Report of the Special Contracts Task Force to the Utah PSC," dated December 17, 1999 reiterates the same basic principles. For example, the 1999 report identified a number of decision criteria to be used in evaluating when it was appropriate of offer a special economic incentive contract. The first of these criteria was that the contract price must cover all incremental capacity and energy costs, including the incremental cost of generation, transmission and distribution as appropriate and make a contribution to fixed costs. The second decision criteria called for economic incentive contracts to provide a net benefit to tariff customers' results, as evaluated by the current IRP and allocation methodology.

Q. US Mag witness Roger Swenson characterizes the 1968 contract as providing "terms and conditions designed to permit the facilities to be constructed and to operate on an economical basis." Do you agree with this description?

A. I would agree that the discounted prices offered by the 1968 contract had the effect described by Mr. Swenson. However, the intent of the Commission's order was to implement a contract that provided benefits to US Mag without disadvantaging existing customers. In 1968, both of these objectives could be realized by adding new interruptible load at discounted prices. As the Commission stated on page 53 of the 1968 order:

> "It is within the statutory authority of this Commission to set a rate which will be reasonable, non-discriminatory, and will not adversely affect the residential, commercial, and other industrial consumers of Utah Power, yet it will be a rate which will enable Magnesium Project to go forward <u>now</u> . . ."

Q. Are PacifiCorp's operating circumstances the same now as they were in 1968?

A. No. Obviously many things have changed in the 36 years since 1968, but one of the most significant differences from the standpoint of this proceeding is that PacifiCorp no longer has surplus generation to offer. In fact, the Company is currently in the process of acquiring new resources to serve its growing Utah and East System load. Another major difference is that the contract currently being proposed by US Mag is no longer "interruptible" in any meaningful sense of the word. In its 1968 order, commenting on Magnesium Project's hoped-for 95 percent load factor, the Commission observed:

> “. . . load factor here does not mean firm power *or guarantees of interruptible power availability* (emphasis added). Mr. Rowley [President of National Lead, 80% owner of the Magnesium Project] was talking of the Project’s operating expectations and, as Mr. Ash [Magnesium Project Manager] said, *the on-site generation is the only power reliability needed*.” (emphasis added) (Pages 50-51)

Now, however, US Mag requires a “buy-through” provision that effectively prevents PacifiCorp from physically interrupting service unless US Mag agrees to be interrupted. US Mag has indicated to PacifiCorp that it must have the buy-through provision because its operations cannot tolerate an interruption longer than one hour in duration. At the same time US Mag is also negotiating to market its self-generation capability to PacifiCorp as a Qualifying Facility (QF), a situation that is different than the 1968 order when this generation was viewed as an enabler for the true interruption of the US Mag load.

Q. Given the changed circumstances that you have just described, does a contract based on the 1968 model, as proposed by US Mag, continue to provide benefits to all PacifiCorp customers?

A. No. As shown by David L. Taylor, The $21/MWH price being proposed by US Mag will not recover the full cost of providing electric service to US Mag. In fact it is significantly below the cost of service for US Mag. Therefore, other PacifiCorp customers will not only receive no benefit from this arrangement, but they will be called on to subsidize the shortfall. Mr. Swenson offers an analysis based on the recent DPU report that purports to show that the $21/MWH rate is cost-based. The errors in the analysis contained in the DPU report are pointed out by Company witness David L. Taylor. In addition, Company witness Bruce W.

Griswold points out some of the errors in the assumption that US Mag can be both a fully interruptible customer and provide reserves at the same time. However, I would like to comment on Mr. Swenson's assertion that the proposed rate will continue to provide a contribution to fixed costs. Leaving aside the accuracy of the numbers, the fact is that "producing a contribution to fixed costs" is irrelevant except when determining how to price incremental new load when there is surplus generating capacity. In the current situation, US Mag is not a new load and all generating resources are being fully utilized. Indeed, PacifiCorp's Integrated Resource Plan shows that considerable additional resources are required to meet continued strong growth. All customers should be bearing their proportional share of all fixed costs. Since at best the proposed rate only produces a "contribution" to fixed costs, it is clear that other customers are being required to pick up the remainder of US Mag's proportionate share of fixed costs--costs that should be borne by US Mag.

Q. Does Mr. Swenson elsewhere admit that the proposed $21/MWH price is not cost based?

A. Yes. On page 2, lines 12-16, Mr. Swenson states:

> "It is clear that US Mag's rates in the past have been based on a combination of economic need for lower cost service and the lower cost to serve the facility on any interruptible basis. US Mag submits that these considerations should continue to set the basis for developing the rate for service going forward."

PacifiCorp believes that in order to ensure fair treatment of all its customers, cost based rates are appropriate. I am advised that this principle is consistent with Utah law, which requires utilities to provide just and reasonable rates based on cost of service and cost of capital. Mr. Swenson makes clear in his testimony that US Mag requires special consideration with respect to rates and terms of service based on the economic “needs” of its business. However, the economic development rate that US Mag proposes would necessarily result in an inappropriate allocation of US Mag-related costs to other customers. As a consequence of providing special treatment to one customer, there would be a negative economic impact on PacifCorp’s other Utah electric customers.

Customer Inequities

Q. Is PacifiCorp concerned about the issues that seem to be threatening the continued economic viability of US Mag?

A. Yes, of course. US Mag is an important and valued customer of PacifiCorp, and we will make every reasonable effort to help them remain competitive. We are willing to continue to work with them to determine the services that they can offer to our customers and to credit them with full value for these services. The Company would also agree that US Mag provides significant economic benefits to the State of Utah. However, the issue from PacifiCorp’s standpoint is that we are committed to provide fair and equitable treatment to all of our customers. We believe that this principle is fundamental to the way we are regulated and is consistent with the laws of this State. As such, we are in no position to offer discounted electric service to US Mag or any other single customer, at the expense of our remaining customers.

Q. Does PacifiCorp have other customers that could benefit from an economic incentive contract?

A. Yes, there are undoubtedly many other industrial and commercial customers that would benefit financially if they could obtain electricity at less than PacifiCorp's cost to serve them. These customers may not have the high visibility of US Mag, but their aggregate impact on the state's economy may be equally or more significant. PacifiCorp is not only unable to offer economic incentives to these customers, but would actually be required to increase their costs in order to subsidize an incentive rate for US Mag. Moreover, approval of an economic development rate for US Mag, which results in costs being passed to other customers, may have the perverse consequence of encouraging other commercial and industrial customers to seek "special" need-based terms, at the growing expense of Utah customers that do not enjoy special provisions.

Q. Mr. Swenson indicates that in the absence of special economic incentive rates, "companies like US Magnesium" would not continue to exist and provide economic benefits to the state. What is your response?

A. I would simply observe that there are no other companies in the State of Utah that argue that they must depend on subsidized electric rates to remain competitive. Indeed, we are aware that economic development agencies use the low electric prices in Utah as a selling point when they seek to attract businesses to Utah. The reality is that, every other customer of PacifiCorp, large or small, is expected to carry its own weight and pay for the full cost of the competitively priced service that it receives.

Q. Does PacifiCorp believe that it is appropriate for the State of Utah to provide economic incentives that would retain jobs in the state and contribute to the tax base?

A. Yes. Such incentives may well be appropriate public policy; but like other economic development programs, they should be developed through a public process and administered by agencies within the state government that have been created for that purpose. PacifiCorp does not believe that it is charged with the role of implementing economic incentives through discounted electric rates. It puts the Company and the Commission in the untenable position of favoring one customer or group of customers at the expense of another.

Q. In addition to the discrimination issue, do you see any practical issues associated with administering economic development or social programs through the Public Service Commission?

A. Yes. Programs that use public money to achieve socially desirable objectives should be reviewed periodically to ensure that they are performing as intended. The review of the Utah HELP program that has been undertaken by the DPU and the Commission is a good example. However, I am concerned that when quasi-social programs are implemented by discounting electric rates, they tend to lose their identity and do not receive the necessary review. For example, US Mag has benefited from a special economic incentive rate since 1968 with no requirement that the company demonstrate its own efforts to minimize costs and operate efficiently during that period. Before additional incentives are provided to US Mag at the expense of other PacifiCorp customers, it would be useful to have an independent verification that US Mag has operated and continues to operate in a prudent and cost effective manner.

Capital Investment

Q. According to Mr. Swenson, US Mag needs to have a workable long-term electric rate established in order to attract the capital required for necessary upgrades. What is your response?

A. In seeking an economic incentive rate, US Mag is essentially extracting a capital contribution from PacifiCorp's other Utah electric customers. I believe that incentive electric rates or any other form of public economic assistance should be provided as a last resort after all other potential sources of capital have been exhausted. I also believe that they are a matter of State policy rather than of utility policy. I see no evidence to confirm that US Mag has fully explored the capital resources available from its current owners. US Mag has thus far refused to respond to the Company's data requests in this proceeding seeking information about the availability of such resources.

Q. What is the ownership structure of US Mag?

A. The company is among the holdings of financier Ira Rennert, who was involved with both MagCorp and the subsequent formation of US Mag. I believe from public reporting that Mr. Rennert is involved with a number of successful businesses and is a very successful businessman. It is not clear from the contract proposed by Mr. Swenson what degree of investment and financial risk the owner of US Mag is undertaking as he seeks to develop and secure that company's continued operation. PacifiCorp believes that a fundamental factor in the future success of US Mag will be the appetite and willingness of its owner to continue to develop and invest in the business. Until US Mag has demonstrably exhausted its own resources and those of its owners, it is inappropriate to ask PacifiCorp's customers to provide what is in effect a capital infusion.

Q. Do you have other concerns about US Mag's financing arrangements?

A. Yes. To remain competitive, US Mag will apparently need to surmount a number of problems in addition to the price it pays for electricity, including lawsuits raised by the bankruptcy trustee, trade relief against imports, and environmental issues. US Mag has offered no guarantee that it can remain solvent even with economic incentive electric service rates. I am concerned that should US Mag suffer a financial failure, subsidies provided by PacifiCorp customers for the purpose of providing economic benefits to Utah may be effectively siphoned-off for the benefit of out-of-state owners or creditors. If US Mag wishes to receive an economic incentive, it should be required to provide assurances that under no circumstances will its owners be enriched at the expense of Utah electric ratepayers.

Contract Term

Q. Mr. Swenson proposes that the new service agreement be in effect for a period of ten years. Do you agree with a ten year contract term?

A. No. There are too many uncertainties involved with the operations of US Mag to lock-in an agreement for ten years. The contract term should be limited to no more than five years, which is consistent with the recommendation of the 1999 Special Contracts Task Force. The 1999 task force report recommended that contracts must be for no more than five years, with no automatic renewals.

Q. What other conditions should be included in the contract?

A. The prices specified by the terms of the contract should be adjusted to reflect increases given to Schedule 9 firm customers in rate cases filed after the contract takes effect.

Q. Mr. Swenson proposes that such increases "should not be allowed to increase US Mag's rate above the lowest-priced special contract customer in the State of Utah or Idaho". Do you agree?

A. No. The notion of pegging the US Mag contract price in Utah to the price paid by an Idaho customer defies basic ratemaking principles and should be rejected out of hand. Further, if the Commission were to adopt a rate that made the US Mag agreement the lowest-priced special contract in Utah, the second portion of his argument would be equally peculiar. US Mag offers no convincing reason why the new contract should not be adjusted for inflation by reflecting changes in Schedule 9 rates over the five-year duration of the agreement.

Q. Based on the foregoing discussion, what base rate is PacifiCorp recommending for a new five-year service agreement with US Mag?

A. The development of an appropriate rate for the new agreement is discussed by Mr. Taylor and Mr. Griswold, from a regulatory and a commercial perspective, respectively. Both witnesses agree that the appropriate rate is in the range of $29/MWH.

Introduction of Witnesses

Q. Please list the other Company witnesses providing testimony in this docket and provide a brief description of their subject matter.

A. The other Company witnesses providing direct testimony are:

David L. Taylor, Director of Revenue Requirement and Cost of Service, presents PacifiCorp's Cost of Service results in support of a new contract for US Mag. He also rebuts several issues raised in the testimony of Mr. Swenson and addresses his concerns with a number of the cost of service representations contained in the US Magnesium Interruption 2003 Report (USM Exhibit 1.1).

Bruce W. Griswold, Manager in the Origination section of the Commercial and Trading Department, explains and clarifies the costs and appropriate terms and conditions for acquiring interruptibility or curtailment as a power supply resource. He also responds to US Mag's proposed terms and conditions of interruptibility as presented in Mr. Swenson's testimony.

Q. Does this conclude your direct testimony?

A. Yes.