

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of)
PACIFICORP for a Certificate of)
Convenience and Necessity Authorizing) Docket No. 04-035-30
Construction of the Lake Side)
Power Project)

REBUTTAL TESTIMONY OF DAVID J. MENDEZ

October 15, 2004

1 **Q. Please state your name, business address and present position with PacifiCorp.**

2 A. My name is David J. Mendez. My business address is 825 N.E. Multnomah, Suite
3 1900, Portland, Oregon. I am the Chief Accounting Officer for PacifiCorp.

4 **Purpose of Testimony**

5 **Q. What is the purpose of your testimony?**

6 A. The purpose of my testimony is to rebut the allegation in the testimony of Roger
7 Weir, a witness for the Utah Association of Energy Users Intervention Group (UAE)
8 that PacifiCorp's accounting evaluation constituted a "landmine" in the RFP process.
9 The accounting decisions involved input from key internal parties in this process such
10 as the bid evaluation team and were validated by the Company's external auditor.

11 **Q. What accounting determinations were involved in the RFP process?**

12 A. The applicable accounting guidance is Emerging Issues Task Force ("EITF") 01-08,
13 *Determining Whether an Arrangement Contains a Lease*, and Financial Accounting
14 Standard ("FAS") 13, *Accounting for Leases*.

15 **Q. Would you please explain the financial statement impacts of the EITF 01-8 and**
16 **FAS 13?**

17 A. EITF 01-08 addresses an issue commonly known as "off balance sheet financing."
18 The intent of this standard is to provide better transparency to potential investors,
19 shareholders and bondholders regarding the fixed obligations of an entity for financial
20 reporting purposes. Under EITF 01-08, PacifiCorp is required to review contracts
21 executed or modified after July 1, 2003 to determine whether or not they contain a
22 lease. If it is determined that a lease exists, the EITF states that an evaluation must be
23 performed under FAS 13 to determine if the lease is capital or operating. If, after

1 reviewing the contract under the FAS 13 criteria, it is designated to be a capital lease
2 then PacifiCorp would be required to record the contract as debt on its balance sheet
3 with a corresponding capital lease asset on the balance sheet.

4 **Q. Based on your evaluation of EITF 01-8, did the proposal submitted by Bidder**
5 **213 contain a lease?**

6 A. Yes. Our determination was validated by our external auditors,
7 PricewaterhouseCoopers (“PwC”), in a consultation memo dated December 24, 2003.
8 A copy of the consultation memo is attached as Confidential Exhibit UP&L ____
9 (DJM-1R).

10 **Q. What are the FAS 13 criteria for determining if a lease is capital or operating?**

11 A. If a contract meets any one of the following conditions, it is considered a capital lease
12 and a debt obligation is recorded on the purchaser’s books:

- 13 i. Ownership transfer at the end of term;
- 14 ii. Bargain purchase option;
- 15 iii. Term greater than 75 percent of the estimated economic plant life; or
- 16 iv. Net present value (NPV) of minimum lease payments, less executory costs,
17 discounted at lessee’s incremental borrowing rate is greater than or equal to 90
18 percent of asset fair value;

19 If a contract does not meet any of the above criteria then the contract is considered an
20 operating lease and a debt obligation is not recorded on the purchaser’s books. The
21 guidance under FAS 13 is mirrored by the FERC equivalent in 18 CFR, Pt. 101,
22 General Instructions, paragraph 19, *Criteria for classifying leases*.

1 **Q. Based on an application of the FAS 13 tests, did the proposal submitted by**
2 **Bidder 213 result in a capital lease?**

3 A. Yes. The fourth FAS 13 criterion is met as the NPV of minimum lease payments
4 exceeded 90% of the asset fair value (cost to build). Again, in its December
5 consultation memo, PwC agreed with our methodology for applying the test outlined
6 in the fourth criteria and that the proposal submitted by Bidder 213 would result in a
7 capital lease.

8 **Q. Did on-going negotiations affect the conclusion in the PwC consultation memo?**

9 A. No. We continued to involve PwC regarding any changes to the proposed contract
10 during the negotiation process that may have impacted their original view contained
11 in their December consultation memo that the proposal contained a lease and that the
12 lease should be classified as a capital lease. PwC agreed with our conclusion in all
13 cases and did not waiver from its original conclusion.

14 **Q. What is the accounting impact of a determination that the proposal was a capital**
15 **lease?**

16 A. The accounting guidelines discussed above provide the methodology for determining
17 the amount of debt associated with a capital lease that must be recorded on
18 PacifiCorp's balance sheet. The accounting group provided this methodology to the
19 pricing and structuring group for an initial determination of the potential impact to be
20 used for bid evaluation purposes.

21 **Q. How did the conclusion that the Bidder 213 proposal was a capital lease impact**
22 **the evaluation of the proposal?**

1 A. Please refer to the testimony of Mr. Bruce Williams who explains the costs associated
2 with the direct debt associated with the capital lease proposed by Bidder 213..

3 **Q. Does this conclude your testimony?**

4 A. Yes.