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, 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. Consistent with Utah statutes, the Company has proposed a future test year in this case that begins on April 1, 2005 and ends on March 31, 2006. This twelve-month test period proposed by the Company corresponds with the Company's 2006 Fiscal Year (FY). The purpose of my testimony is to explain why this test period best reflects the conditions the Company expects to experience in the rate effective period.

Q. Under applicable Utah statutes, how is the test year for a utility general rate case determined?

A. In 2003, the Utah Legislature amended section 54-4-4(3) of the Utah utility code. The earlier version of subsection 3 allowed the Commission to adopt a future test period not to exceed twelve months from the date of filing.

The current language of subsection (3) states:

> (a) If in the commission's determination of just and reasonable rates the commission uses a test period, the commission shall select a test period that, on the basis of the evidence, the commission finds best reflects the conditions that a public utility will encounter during the period when the rates determined by the commission will be in effect.
>
> (b) In establishing the test period determined in Subsection (3)(a), the commission may use:
>
> (i) a future test period that is determined on the basis or projected data not exceeding 20 months from the date a proposed rates increase or decrease is filed with the commission under Section 54-7-12;
>
> (ii) a test period that is:
>
> (A) determined on the basis of historic data; and

(B) adjusted for known and measurable changes; or

(iii) a test period that is determined on the basis of a combination of:

(A) future projections; and

(B) historic data.

(c) If pursuant to this Subsection (3), the commission establishes a test period that is not determined exclusively on the basis of future projections, in determining just and reasonable rates the commission shall consider changes outside the test period that:

(i) occur during a time period that is close in time to the test period;

(ii) are known in nature; and

(iii) are measurable in amount.

Subsection 3 establishes that the standard that governs the Commission's selection of a test period is that it best reflect the conditions that a public utility will encounter when the rates are in effect.

Q. When will the rates likely become effective in this case?

A. Given their complexity, it is typical for orders in general rates cases to become effective near the end of the statutory 240-day period under section 54-7-12(3). Given the fact that this case was filed on August 4, 2004, it is likely that the rates in this case will become effective on April 1, 2005, the same time that the projected test period would commence. In other words, the immediate period following the effective date of the rates in this case and the test period will precisely match each other. Thus, consistent with the new language of section 54-4-4(3), the commencement of the rate-effective period and the commencement of the test period will match each other in this case.

Q. Why is it important that the test period and the rate effective period closely match each other?

A. As the Commission has noted many times, one of the critical underlying principles that govern rate proceedings is the effort to match capital, expenses, and revenues in a test period. A similar matching concept also suggests that, to the extent possible, the rate-effective period and the test period should match each other. It is significant that in the 2003 test period amendment to section 54-4-4, the first alternative for defining an appropriate test period is one that allows the synchronization of the time rates take effect with the commencement of the test period. On the other hand, test periods that are historical in nature will never match these two critical factors and, as I will discuss later, will cause a utility that is operating in a period of rapid expansion and rate base growth to chronically under-earn. My understanding of the law is that a rate base, rate of return regulated utility like PacifiCorp must be given a reasonable opportunity to earn its cost of capital. By statutorily mandating that the Commission give serious consideration to the adoption of the type of future test period proposed by the Company in this case, the Utah Legislature made it clear that it expects that Utah utilities will be give a reasonable opportunity to earn their costs of capital.

Q. What other options are available to the Commission for determining the most appropriate test year?

A. If the Commission should choose not to use a forecast, Utah statutes provide two other options for determining the test period: (1) the test year could be determined on the basis of historic data adjusted for known and measurable posttest year changes; or (2) the test year could be determined on the basis of a combination of future projections and historic data. In either case, if a fully forecast test period is not used, the Commission must consider changes outside the test year that occur during a time period that is close in time to the test period, are known in nature and are measurable in amount.

Q. Why does PacifiCorp advocate the use of a future test year as the preferred option for determining revenue requirement in this proceeding?

A. The Company requires additional dollars not currently reflected in rates. With the rapid growth of the system, the implementation of new approaches to asset management and the implementation of the recommendations from the Storm Report, it is clear to me that the only test period that can adequately reflect this needed expenditure, is the one that includes a clear assessment of the operation maintenance and capital costs PacifiCorp must incur in order to deliver these initiatives and meet all of the objectives it faces in the near future. The FY 2006 future test year is the only possible test year capable of meeting this need and properly reflecting for rate setting purposes the costs the Company must incur in the rate effective period to provide the level of service it is planning for its customers.

Q. Is it your assertion that no other test period available to the commission can adequately reflect the conditions that will be in place during the rate effective period?

A. Yes it is. While in other circumstances this may not be the case, I believe that there is a compelling argument that the future projected test period best reflects the conditions that the Company will encounter. Put simply, historical or even "hybrid" test periods can not accurately reflect the significant programs and activities that are planned for the rate effective period. The only test period that can accurately reflect this significant investment and development of programs and initiatives is one that takes into account the costs required to perform these activities.

Q. If you receive these increases, how can the Commission be assured that this additional funding will be used for the benefit of customers?

A. As part of a fast growing business, I recognize that in this period of rapid system growth there will be an ongoing need to continue a high level of investment in the system in order to deliver high and increasing levels of reliability. Many of the activities that I describe are ongoing assessment and enhancement programs, and initiatives, such as vegetation management, that require a stable level of funding going forward.

Q. Wouldn't a test year based on historic data with known and measurable changes also capture increasing costs?

A. No. Modest increases over historic levels can be identified and captured through known and measurable adjustments. However, even when selective known and measurable adjustments are employed sparingly, they inevitably raise concerns about the creation of mismatches between revenues and expenses. When conditions in the rate effective period are expected to differ dramatically from historic experience (as is the case in this proceeding), the only logical approach is to forecast all of the interrelated components of revenue requirement in order to avoid the possibility of significant mismatches.

Q. Isn't it true that historic test years, with varying degrees of adjustments, have been used successfully in recent PacifiCorp Utah general rate cases?

A. It is true that since the mid to late 1980s, the Commission has shown a preference for historic test years with minimal adjustments. During this time, the Company's revenue requirement (excluding the effects of the Western Energy Crisis) has been relatively stable. Yet, despite this relative stability, historical test years have nevertheless resulted in rates that have resulted in the Company being unable to earn its authorized rate of return for at least the last seven years. Exhibit UP&L___(DDL-1), which compares the Company's authorized, actual and normalized return on equity (ROE) for the years 1999 through 2004, clearly shows this earnings deficiency. Recently, however, the Commission has been willing to use more forwarding looking data to determine revenue requirement. The Company's May 2003 general rate case employed a partial future test year. Since that case, PacifiCorp's ability to earn its cost of capital in Utah has become even more threatened, with the rapid rate of increase in certain O&M and rate base categories that hearkens back to the heavy plant construction era of the early 1980s, when it was not unusual for the Commission to adopt future test years in Company rate cases.

Q. Would the use of a historical test year adjusted for known and measurable changes produce a totally objective revenue requirement?

A. No. It would be subjected to the same criticisms that that would be leveled at a future test year. The disputes would simply shift from the choice of forecasting techniques to the choice of known and measurable adjustments. At least the forecasting techniques would be applied consistently in order to synchronize revenues, expenses, capital additions and other revenue requirement elements. This use of matching all key components of the case further strengthens the use of the future test year. A historic test year with known and measurable adjustments is conceptually inferior to a full forecast for reflecting conditions in the rate effective period.

Q. Is it possible to devise a test period that is free from some element of Prediction?

A. Of course not. The reality is that the Commission is charged with setting rates for a future, not a historical, period and that inevitably involves a certain amount of informed predictions of the future. However, the Legislature knew that when it enacted the amendments to section 54-4-4(3). In prior years, historic test periods with no out-of-period adjustments have been used in an effort to remove Company judgment and discretion from the calculation of the revenue requirement. However, given the dynamic nature of the world in general and the electric industry in particular, it is unlikely that a pure historic test year will ever “best reflect” the conditions in the rate-effective period; and, in fact, an unadjusted historic test year is not even an option that is available to the Commission under section 54-4-4. All of the test year options available under the statute require the Company to exercise informed judgment about how to best project future data or adjust historical data to reflect conditions in the rate effective period.

Q. Do you believe that in selecting the appropriate test year, the Commission should attempt to choose the approach that is based on the best evidence of the conditions in the rate-effective period?

A. Yes. The Commission's statutory charge is select the test period that, in the exercise of its judgment based on the evidence, will best reflect the conditions in the rate effective period. In the final analysis, the Commission will want to select the most realistic, fair and reasonable period for test-year purposes that reflects the unique circumstances of the case.

Q. Does the Company have any incentive to be as accurate as possible in forecasting the test year data which it proposes to use in this proceeding?

A. Yes. PacifiCorp fully understands that by proposing a forecasted test year, it is putting its credibility on the line. It does not believe that the use of a forecasted test year in this proceeding will be a one-time event. Frankly, the Company has no reason to believe that load growth with its associated costs will not be continuing in Utah in the years ahead. For example, the Commission acknowledged Integrated Resource Plan calls for significant new generation resources across the PacifiCorp system. As the largest state, Utah will see a considerable portion of these costs. Under these circumstances, the PacifiCorp believes that it must establish its ability to produce reliable test year forecasts if the Company is to continue to recover its costs and remain financially viable. The Company also understands that its efforts will be closely scrutinized by those who would like to see it fail in this effort. Thus, PacifiCorp is under tremendous pressure in this proceeding to produce and support a reasonable future test year.

Q. Has the preparation of the Company's future test year forecast in this case been closely scrutinized?

A. Yes. For the reasons I have just described, there has been great attention to detail in the preparation of this forecast. Every effort has been made to "scrub" the data, in the sense that we have worked hard to maintain internal consistency (matching revenues and expenses) and to provide an appropriate audit trail. Throughout the preparation of the forecast, we have used a "bottom-up" approach to ensure that the business units that will actually be spending the dollars in FY 2006 to build, operate and maintain the system are in agreement with the projected levels of expenditure.

Q. By adopting the future test year approach proposed by PacifiCorp in this proceeding, would the Commission also be accepting all of amounts reflected in the Company's filing?

A. No, of course not. There may be differences of opinion about the proper application of forecasting techniques and the calculation of individual inputs into the revenue requirement. Such differences are inevitable in a general rate case where the parties have different perspectives. PacifiCorp is not asking the Commission for a blanket validation of its forecast calculations. Rather, the Company is asking the Commission to accept the concept of a future test year as being the most appropriate way to provide timely recovery for the increased level of expenditures that are required to be made to serve the growing Utah load. The Company accepts full responsibility for demonstrating the appropriateness of its forecast calculations and would expect adjustments to be made to any forecasted costs that the Commission determines to be unreasonable.

Q. Do you have any other general observations about the use of a future test year?

A. The Commission is required by statute to choose the test period that best reflects the conditions in the rate effective period. The Utah Legislature has explicitly made a future test year option available to the Commission; and, in fact, the future test year is the first of the three options listed. The use of a forecast test year is most compelling when costs are changing dramatically (up or down) from historic levels. PacifiCorp now finds itself in a period where both capital and O&M costs are increasing significantly to meet growing customer demand for electricity. If the Commission is not willing to adopt a future test year under these circumstances, I would have to question whether it will ever be willing to do so. I do not believe that the Legislature would have authorized the use of a future test year if it were not convinced that such an option must occasionally be necessary to best reflect the conditions in the rate-effective period. In fact, I believe that PacifiCorp's current circumstances are a perfect example of the need for a future test year that was anticipated by the Legislature.

Summary

Q. Please summarize your conclusions about the appropriate test year to be used by PacifiCorp in this proceeding.

A. The test period used in this proceeding must satisfy two objectives. It must best reflect the conditions in the rate-effective period as required by statute, and it must provide PacifiCorp with a reasonable chance of fully recovering the escalating costs of serving the growing electrical needs of its Utah customers. There is simply no way that a historical test year, even with selected adjustments, can recover the increased O&M expense and capital required to serve this growing load. These costs are only exacerbated by the fact that the load is growing faster on peak than it is overall. Based on historical test years, the Company has not been able to earn its authorized rate of return for at least the last seven years. The fact is that in order to have an opportunity to recover its full cost of service and earn its authorized return on equity, PacifiCorp must employ a test year that is properly matched with the rate-effective period. Therefore, the Commission should approve for purposes of this proceeding, a future test year beginning April 1, 2005 and ending March 31, 2006.

Q. Does this conclude your direct testimony?

A. Yes.