Witness CCS - 1
Exhibit CCS - 1

BEFORE THE PUBLIC SERVICE COMMISISON OF UTAH

In the Matter of the Application	**)**	**Docket No. 04-035-42**
Of PacifiCorp for Approval of	**)**	**PRE-FILED DIRECT TESTIMONY OF**
Its Proposed Electric Service	**)**	**DONNA DERONNE**
Schedules and Electric	**)**	**FOR THE COMMITTEE OF**
Service Regulations	**)**	**CONSUMER SERVICES**

REDACTED

December 6, 2004

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<u>INTRODUCTION</u>

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. I am Donna DeRonne, a Certified Public Accountant licensed in the State of Michigan. I am a regulatory consultant in the firm Larkin & Associates, PLLC, with offices at 15728 Farmington Road, Livonia, Michigan 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES, PLLC?

A. Larkin & Associates, PLLC is a Certified Public Accounting and Regulatory Consulting firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorney generals, etc.). Larkin & Associates, PLLC, has extensive experience in the utility regulatory field as expert witnesses in over 400 regulatory proceedings, involving electric, gas, telephone and water and sewer utilities.

Q. HAVE YOU PREPARED AN EXHIBIT DESCRIBING YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Appendix I, which is a summary of my experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Larkin & Associates, PLLC, was retained by the Committee of Consumer Services (CCS or Committee) to analyze the reasonableness of PacifiCorp's (Company) request for a $123.6 million increase in its Utah Jurisdictional revenue requirement and to make recommendations to the Utah Public Service Commission (Commission) in the areas of rate base and operating income (expense and revenue).

Q. HAVE YOU PREPARED ANY EXHIBITS IN SUPPORT OF YOUR TESTIMONY?

A. Yes. I have prepared CCS Exhibits 1.1 through 1.25, which are attached to this testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I present the overall revenue requirement recommended by the Committee and sponsor specific adjustments to the Company's filing for the future test year ending March 31, 2006 (fiscal year 2006 or FY '06). The overall revenue requirement presented in the summary schedules, specifically CCS Exhibits 1.1 and 1.2, includes the impact of recommendations of other witnesses testifying on behalf of the Committee. It includes the recommended return on equity and capital structure presented by Committee witness Daniel Lawton, as well as specific adjustments recommended by Committee witnesses Randall Falkenburg, Philip Hayet, Helmuth Schultz, Michael Arndt and Kim

Dismukes. The overall revenue requirement also includes the recommended consolidated tax savings adjustment, as sponsored by Committee Witness Michael Arndt.

Q. PLEASE DISCUSS HOW YOUR EXHIBITS ARE ORGANIZED?

A. CCS Exhibit 1.1, pages 1 through 38 presents the overall revenue requirement and summary schedules reflecting the impact of the MSP Protocol stipulation, which caps PacifiCorp's FY 2006 Utah revenue requirement at 101.5 percent of the Utah revenue requirement calculated under the rolled-in allocation method. Each of the pages in CCS Exhibit 1.1 are based on the rolled-in allocation method. CCS Exhibit 1.2, pages 1 through 38, present the overall revenue requirement and summary schedules reflecting the MSP revised protocol jurisdictional allocation methodology (revised protocol method). In preparing both of these summary exhibits, CCS Exhibit 1.1 and 1.2, I used the Company's Jurisdictional Allocation Model, flowing each of the Committee's recommended adjustments through the model. The Company's model was used so that the impact of the Committee's various adjustments on the jurisdictional allocation factors are incorporated.

CCS Exhibit 1.3 consists of the Embedded Cost Differential calculation from the jurisdictional allocation model that is used in the revised protocol method. The Embedded Cost Differential calculation on CCS Exhibit 1.3

includes a correction of a Company error in the Mid-Columbia contract cost section, the impact of various Committee adjustments on the calculations, as well as revisions to the Mwhs recommended by Committee witness Phillip Hayet. However, CCS Exhibit 1.3 does not impact the Committee's overall recommended revenue requirement as rates will be set in this case based on the MSP Protocol stipulation, which caps PacifiCorp's revenue requirement at 101.5 percent of the Utah revenue requirement calculated under the rolled-in accord method. The Embedded Cost Differential calculation does not impact the rolled-in allocation method.

The remaining exhibits attached to my testimony, CCS Exhibits 1.4 through 1.25, consist of the supporting calculations for the specific adjustments I recommend the Commission adopt. These supporting exhibits are presented using the top-sheet approach, showing the specific adjustments on a total Company and Utah allocated basis with brief descriptions of the adjustments at the bottom of each exhibit. In determining the Utah allocated impact of each adjustment in the exhibits, the revised protocol jurisdictional allocations factors contained in Company Exhibit JTW-1 are used, consistent with how PacifiCorp's filing in Exhibit JTW-1 was presented. In discussing each of the adjustments in this testimony, the Utah amounts are based on PacifiCorp's allocation factors associated with the revised protocol method. However, the overall summary schedules, CCS Exhibit 1.1 under the rolled-in allocation method and CCS Exhibit 1.2 under the revised protocol method, include the allocation factors resulting from the Committee's recommended adjustments to the Company's filing.

Q. BASED ON THE COMMITTEE'S ANALYSIS OF PACIFICORP'S FILING, WHAT IS THE COMMITTEE'S RECOMMENDED CHANGE TO THE CURRENT LEVEL OF UTAH REVENUE REQUIREMENT?

A. PacifiCorp's filing shows a requested increase in revenue requirement of $123.6 million based on the revised protocol method, reduced to $111.0 million based on the 101.5% cap set forth in the MSP stipulation. Based on the Committee's analysis, the Company's request is significantly overstated. <u>The Committee recommends that the current level of Utah revenue requirement be decreased by $38,893,488.</u>

As shown on CCS Exhibit 1.2, page 1, using the revised protocol method decreases the current level of Utah revenue requirement by $26,802,962. As shown on page 1 of CCS Exhibit 1.1, using the rolled-in allocation method decreases the current level of Utah revenue requirement by $55,399,542. CCS Exhibit 1.1, page 1 also shows the Committee's overall recommended revenue requirement decrease of $38,893,488, which reflects the 101.5% cap in effect for fiscal year 2006.

RATE BASE ADJUSTMENTS

Q. WHAT ADJUSTMENTS TO RATE BASE DO YOU SPONSOR?

A. I am sponsoring several adjustments to PacifiCorp's projected fiscal year 2005 and fiscal year 2006 additions to plant in service, customer deposits and cash working capital. I will discuss each of the adjustments below.

Additions to Plant in Service

Q. SINCE A FUTURE TEST PERIOD IS BEING USED IN THIS CASE, WHAT LEVEL OF PROJECTED CAPITAL ADDITIONS TO PLANT IN SERVICE DID PACIFICORP INCLUDE IN ITS FILING?

A. PacifiCorp's projected capital additions to plant in service ("plant additions") for fiscal years 2005 and 2006 were presented in its Exhibit JTW-1, pages 8.11 and 8.12, with supporting pages 8.12.1 through 8.12.38. On a total Company basis, the filing includes projected plant additions for fiscal years 2005 and 2006 of $614,982,397 and $996,426,899, respectively. Included in the projected fiscal year 2006 plant additions is $348,305,956 for the Current Creek generation facility, which leaves $648,120,943 for other fiscal year 2006 plant additions. The projected fiscal year 2006 plant additions flow through the Company's filing on a 13-month average basis to reflect the average test year methodology.

Q. HAVE YOU REVIEWED THE REQUESTED PLANT ADDITIONS CONTAINED IN THE COMPANY'S FILING?

A. Yes, I have to the degree possible with the information provided. The projected plant additions are presented on pages 8.12.1 through 8.12.38 of PacifiCorp's Exhibit JTW-1 and consist of over 1,960 individual listed additions. Many of the line items pertain to individual projects being added at specific dates in the filing, while numerous items are for general project work that are being added evenly over each year on a monthly basis. In data request CCS 6.32, the Company was requested to provide the following information for each project being added in the filing exceeding $2 million: a detailed description of the project; a copy of any cost/benefit analysis or studies conducted by or for the Company associated with the project; any written project justifications in the Company's possession, custody or control; the work order for the project; and to identify any project cost savings including supporting workpapers and explanations. Additionally, the Company was asked in data request UIEC 1.39 to provide copies of any cost/benefit study or similar analysis performed for capital projects included in the additions exceeding $3 million. The Company's response referred to CCS 6.32.

Q. DID THE COMPANY PROVIDE THE REQUESTED SUPPORTING INFORMATION FOR ALL OF THE PROJECTS BEING ADDED TO

PLANT IN SERVICE IN THE FILING IN FISCAL YEARS 2005 AND 2006 THAT EXCEED $2 MILLION?

A. While some supporting information and expenditure requisitions were provided for many of the projects, support was not provided for all of the projects. There were many instances in which no information was provided by the Company for the project. Additionally, for several of the projects for which expenditure requisition forms were provided, the expenditure amounts included in the forms differed, in some cases substantially so, from the amounts included in the filing for the project. This was particularly the case for projects related to information services. Many of the expenditure requisitions provided had not yet been signed or approved. The response to CCS 6.32 also indicated that the Company did not yet have expenditure requisitions for some of the fiscal year 2006 projects.

Q. FOR SOME OF THE LARGER PROJECTS IN WHICH NO EXPENDITURE REQUISITIONS OR SUPPORTING INFORMATION WAS PROVIDED IN RESPONSE TO CCS 6.32, WERE THERE OTHER SOURCES TO WHICH YOU COULD CHECK FOR EITHER APPROVAL OF THE PROJECT OR FURTHER PROJECT DETAILS?

A. To a degree. The PacifiCorp Investment Committee (PIC) reviews all proposed projects exceeding $3 million. PIC approval is required for projects exceeding $3 million. In response to CCS data request 26.11, the

Company provided a copy of the minutes of the PIC meetings for the period March 2003 through October 2004. I was able to find approvals for some of the larger projects in the PIC meeting minutes, but not for all of the projects. Also, the PIC meeting minutes provide a description of the project, but do not always provide the projected costs or the supporting cost details.

Additionally, the Company provided a copy of the 2004 Power Delivery Business Plan, dated June 16, 2004, which is discussed in more detail later in this testimony. The Power Delivery plan provided listings of projected capital expenditures for the Power Delivery area, including additions to transmission, distribution and certain information technology projects.

Q. DO YOU HAVE ANY CONCERNS WITH THE LEVEL OF PROJECTED PLANT ADDITIONS INCLUDED IN THE FILING OR REASONS TO BELIEVE THAT THE AMOUNTS ARE OVERSTATED?

A. Yes. There are three primary factors that lead to concerns regarding the reasonableness of the level of plant additions included in the Company's filing. First, for many of the larger projects exceeding $2 million, the Company has provided no information or support beyond the one line identifying the project in Exhibit JTW-1. Given this is the first PacifiCorp rate case in approximately 20 years where a future test year is being used to set new rates, the Company is acutely aware of parties' concerns regarding the reliability of the projected data and the need to provide detailed supporting information.

Begin Confidential

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Q. WHAT SPECIFIC ADJUSTMENTS TO PLANT IN SERVICE DO YOU RECOMMEND THE COMMISSION ADOPT?

A. I recommend the Commission adopt adjustments in four separate areas. First, I recommend that the second phase of Current Creek be removed from plant in service. The Company added this project to its projected additions in March 2006; therefore, it is included in the Company's filing for one month in determining the 13-month average plant in service balances. Second, I recommend reductions to several projects because they have been completed at a cost that is considerably less than the cost included in the Company's filing. Third, I recommend a global reduction to the level of IT plant additions included in the Company's filing for fiscal year 2005. Finally, I recommend removing several of the projects included in the Company's filing for which it has provided no support (i.e., expenditure requisitions or PIC approval).

Q. WHY ARE YOU RECOMMENDING THAT THE SECOND PHASE OF CURRENT CREEK BE REMOVED?

A. The Company has projected that this phase (conversion to the 2x1 combined-cycle configuration) will be completed and transferred to plant in service in March 2006, the final month of the future test year. The Company has not included the benefits of the second phase of this project in its net power cost calculations in this case. It clearly is not appropriate to include the balance in plant in service for the last month of the test year if the benefits to net power costs resulting from the plant coming on-line are not also reflected in that same month. Apparently the Company has included the project in plant in service beginning March 2006, but does not project it to actually be used and useful in that month. Additionally, I have previously addressed concerns regarding the year-to-date capital expenditures in the confidential testimony. Considering that information, it is very likely that some projects will slip and not be completed by the anticipated dates included in the filing, particularly those projects which are scheduled to be completed in the last few months of the future test year. The removal of the second phase of Current Creek is shown on CCS Exhibit 1.4, resulting in a $17,023,535 ($7,134,241 Utah) reduction to average future test year plant in service, a $586,767 ($245,903 Utah) reduction to accumulated depreciation and a $586,767 reduction to depreciation expense ($245,903 Utah).

Q. PLEASE DISCUSS YOUR SECOND GROUP OF REVISIONS PERTAINING TO PROJECTS WHOSE COSTS ARE EXPECTED TO BE LESS THAN THE PROJECTED COST LEVELS CONTAINED IN THE COMPANY'S FILING.

A. CCS data request 6.31 asked the Company to provide for each of the plant additions it identified in its filing to be placed into service during the period April 2004 to August 2004 the following information: (1) the actual amount placed into service; (2) the actual date placed into service; and (3) to explain any variances over 10%. The Company was also asked to update the response as additional months become available. (The Company has provided no updates beyond the August 2004 information.)

In response to CCS data request 6.31, the Company listed many variances that exceeded 10%. The majority of the variances were caused by timing issues or projects included in the filing as being added evenly throughout the year. However, for a few projects there were larger variances that need to be addressed. On CCS Exhibit 1.5, I reflect revisions to the additions to plant in service included in the Company's filing for several of the larger projects in which the actual amount placed into service or the actual revised forecasted amount is somewhat lower than what was included in the filing. These include the following projects:

- U4 Precip. Upgrade – Project was included at $1,654,203. The actual amount placed into plant in service was $1,241,761 with the variance being caused by the Company expensing part of the project instead of capitalizing it. The expenditure requisition also identified the project as projected at $1,217,910 as opposed to the $1,654,203 included in the filing.

- Purchase Seed Rotor for Main Generators – Project included in filing at $3,563,008 and was completed and placed in service for $2,855,898. The expenditure requisition estimated the project cost at $2,969,067.
- Craig 1,2: Emission Control Upgrades – Included in the filing for $11,366,738 and actually completed for $9,578,158.
- Clearfield – Build New 138/12.5kV 60MVA sub – Included in the filing for $6,822,949 and currently forecasted at $5,217,000.

Q. WERE THERE ANY PROJECTS LISTED IN THE RESPONSE WHERE THE AMOUNT ACTUALLY PLACED INTO SERVICE EXCEEDED THE PROJECTED AMOUNT INCLUDED IN THE FILING?

A. Yes, there were some. However, on an overall basis, the response to CCS data request 6.31 indicated that the actual amount placed into service through August 2004 was quite a bit lower than the projected additions included for the same period, and the adjustments I am recommending above do not make up for the entire difference. As I indicated earlier in my testimony, many of the differences were due to timing issues and the Company’s assumption on several projects that amounts would be placed into service evenly throughout the year.

Consequently, I am not recommending that the entire difference be addressed at this point, but I am limiting my recommendation to the items identified above. Additionally, my recommendations discussed below regarding information technology plant additions will also effectively address some of the variances in projects placed into service for the current fiscal year to date.

Q. WHY ARE YOU RECOMMENDING A GLOBAL APPROACH FOR ADDRESSING THE INFORMATION TECHNOLOGY PLANT ADDITIONS?

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A.

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Q. HOW DID YOU CALCULATE THE IMPACT ON THE FUTURE TEST YEAR OF YOUR RECOMMENDED $6,390,000 REDUCTION TO FISCAL YEAR 2005 INFORMATION TECHNOLOGY PLANT ADDITIONS?

A. Based on a review of section 8.12 of Company Exhibit JTW-1, approximately 1/3rd of the cost of information technology projects for fiscal year 2005 are included in general plant, with the majority of the remaining 2/3rd in intangible plant. Thus, I allocated my recommended $6.39 million reduction to information technology plant additions for fiscal year 2005 between general plant and intangible plant using the same ratios. As shown on CCS Exhibit 1.6, this results in a $2,130,000 ($886,266 Utah) reduction to general plant and a $4,260,000 ($1,772,532 Utah) reduction to intangible plant. This recommendation results in a $477,339 ($198,615 Utah) reduction in both accumulated depreciation and depreciation expense in the future test year.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR PROJECTS THAT REMAIN UNSUPPORTED?

A. As previously discussed, CCS data request 6.32 asked the Company to provide, for all projects exceeding $2 million for which all or a portion is allocated to Utah, a detailed project description, cost-benefit studies, project justifications, work orders and any projected savings resulting from the project. The Company provided copies of expenditure requisitions for only some of the capital projects. The response indicated that expenditure requisitions have not yet been prepared for some of the fiscal year 2006 projects. For many of the projects, no information was provided, not even project descriptions. For a few of the projects exceeding $3 million in which neither an expenditure requisition or project description was provided, I was able to locate the projects in the PIC meeting notes approving the projects, but not for all of the unsupported projects. Consequently, I recommend removing the larger projects that PacifiCorp has failed to adequately support in its filing.

Q. WHAT SPECIFIC UNSUPPORTED PROJECTS ARE YOU RECOMMENDING FOR REMOVAL FROM THE TEST YEAR?

A. Each of the projects that I am recommending for removal can be found on CCS Exhibit 1.7, page 2 of 2. This page provides for each project recommended for removal the total projected project cost included in the filing, as well as the impact on 13-month average future test year plant in service, accumulated depreciation and test year depreciation expense. The Company has not adequately demonstrated that these projects are known and measurable: no project description has been provided; no project expenditure requisitions were provided; and the projects have not been approved by the PIC.

As shown on CCS Exhibit 1.7, page 2 of 2, I recommend eighteen specific projects be removed from the test year. For one of these projects, the Company did provide an expenditure requisition. However, the requisition provided differed substantially from the amount included in the Company's filing. The removals on the referenced exhibit are incremental to the general information technology project reductions reflected in CCS Exhibit 1.6.

Q. PLEASE DISCUSS THE ONE PROJECT ON YOUR EXHIBIT THAT DID HAVE AN EXPENDITURE REQUISITION THAT WAS PROVIDED BY THE COMPANY AND WHY YOU ARE STILL RECOMMENDING THE PROJECT BE REMOVED.

A. The Company's filing, in Exhibit JTW-1, page 8.12.11, includes a project titled "U1 Huntington ESP" for $20,500,000 shown as being added in November 2005. In response to CCS data request 6.32, the Company provided a copy of an expenditure requisition titled "HTG U1 ESP Partial Rebuild FY 2005." The expenditure requisition was dated September 4, 2003 and indicates that the project will be an ESP partial rebuild estimated to cost $12,198,037. The expenditure requisition indicated that a full rebuild is estimated at $15 to $20 million, but that only a partial rebuild was being recommended for approximately $10 to $11 million. The Company has provided no justification for its full cost projection included in the filing of $20,500,000. Additionally, the expenditure requisition provided by the Company indicates that an environmental review is pending and the requisition apparently has not yet been approved as it contained no signatures. Additionally, the project was not referenced in the PIC meeting minutes that have been provided. Consequently, I am recommending that this project be removed from the test year.

Q. ON EXHIBIT CCS 1.7, YOU ALSO INDICATE THAT YOU ARE REMOVING ANOTHER PROJECT AT HUNTINGTON UNIT 1 FOR A LOW NOX BURNER. WHY IS THIS PROJECT BEING REMOVED?

A. First, the Company has not provided an expenditure requisition for this project, which is included in the Company's filing at a November 2005 figure of $10,383,793. The October 1, 2003 PIC meeting notes (provided in response to CCS data request 26.11) indicate that Low NOx Burners were being requested for Huntington Unit 1, Jim Bridger Unit 2 and Hunter Unit 3. The notes indicate that the project was approved in principle to move forward, but that it is "…subject to FY05-06 budget earnings impact review and outcomes prior to funds being committed…" In minutes from a subsequent PIC meeting, dated August 9, 2004, certain Huntington Unit 1 overhaul projects were approved, subject to approval of the total overhaul package. In the notes discussing the projects, the minutes discuss the Low NOx Burners as a future installation and is not referenced as part of the anticipated upcoming overhaul. Apparently the potential project has been deferred. There are several places in the notes that reference the Low NOx burner as a future modification which is not referenced as part of the overhaul projects approved to date by the PIC. Consequently, I have removed this project on CCS Exhibit 1.7.

Q. DO YOU HAVE ANY FURTHER COMMENTS ON ANY OF THE PROJECTS YOU REMOVED AS UNSUPPORTED?

A. Yes. In a supplemental response to CCS 6.7, the Company provided a copy of its revised 2004 Power Delivery Business Plan, dated June 16, 2004. This plan was used by the Company to project the future test year operation and maintenance expenses for many of the FERC accounts. I was able to trace many of the Company's larger projected transmission, distribution and information technology plant additions to the Plan. However, the following projects included in the filing as being added to either transmission, distribution or Power Delivery Information Technology do not appear in the revised Power Delivery Business Plan for fiscal years 2005 or 2006: Bend Area Wind Interconnection Project; Lakeside Sub Construct New 138-12 sub; Hale Sub – increase capacity; BDO industrial park – construct new sub & line; Green Canyon Sub – Increase Capacity; Chapel Hill Sub – Construct new 138-12 Sub; Pleasant Grove Sub – Convert to 138kV and add 2nd; and Other IT initiatives. Additionally, no descriptions or expenditure requisitions were provided for these projects.

Q. WHAT IS THE OVERALL IMPACT FROM REMOVING THE EIGHTEEN UNSUPPORTED PROJECTS?

A. As shown on CCS Exhibit 1.7, page 1, the impact is a $42,025,802 ($26,518,662 Utah) reduction to average future test year plant in service, a $1,342,017 ($788,532 Utah) reduction to accumulated depreciation and a $1,082,043 ($681,509 Utah) reduction to depreciation.

Q. DID YOU REFLECT THE IMPACT OF YOUR RECOMMENDED ADJUSTMENTS TO PLANT ADDITIONS ON THE ACCUMULATED DEFERRED INCOME TAX OFFSET TO RATE BASE?

A. No, not at this time. I was unable to isolate the impact on accumulated deferred income taxes associated with each of the Company's projected additions to plant in service using its filing and associated electronic workpapers. I intend to work with the Company to obtain the information necessary to reflect the impact of my plant addition adjustments on accumulated deferred income taxes.

<u>Customer Service Deposits</u>

Q. HAS THE COMPANY INCLUDED CUSTOMER SERVICE DEPOSITS AS AN OFFSET TO RATE BASE, CONSISTENT WITH PAST COMMISSION PRACTICE?

A. Yes. PacifiCorp’s filing includes an offset to rate base of $7,817,274 based on the actual balance of Utah customer service deposits as of March 31, 2004. Additionally, future test year expenses include $344,617 moved to above the line expenses for interest paid by the Company on the customer deposits. According to Company adjustment 4.5 in Exhibit JTW-2, the interest expense amount is based on the actual amount of interest expense on customer deposits recorded by the Company during fiscal year 2004. In past cases, the Commission has included both the deduction to rate base for customer service deposits and the associated interest expense as above the line costs in determining the cost of service.

Q. DO YOU RECOMMEND THAT THE AMOUNT OF OFFSET TO RATE BASE FOR CUSTOMER DEPOSITS IN THE FUTURE TEST YEAR REMAIN AT THE MARCH 31, 2004 ACTUAL LEVEL?

A. No, I do not. The response to CCS data request 26.8 provides the monthly balance of Utah customer service deposits for the period February 2002 through October 2004. The amount of customer service deposits has been steadily increasing. In fact, as of October 2004, the actual balance was $9,139,069, which is considerably higher than the March 31, 2004 balance included in the Company's filing.

Q. WHAT ADJUSTMENT TO THE CUSTOMER SERVICE DEPOSIT OFFSET TO RATE BASE DO YOU RECOMMEND?

A. As shown on CCS Exhibit 1.8, I recommend that the Utah customer service deposits be increased by $4,299,510 to reflect a projected test year 13-month average balance of $12,116,784. The projected test year average balance was estimated by applying the fiscal year 2004 average monthly increase in the account to the most recent actual balance available and continuing the trend through the end of fiscal year 2006. The 13-month average balance is based on this trend analysis.

Q. SINCE YOU ARE RECOMMENDING AN INCREASE IN UTAH CUSTOMER SERVICE DEPOSITS TO REFLECT A PROJECTED AVERAGE TEST YEAR BALANCE, SHOULD THE ASSOCIATED INTEREST EXPENSE ALSO BE INCREASED?

A. Yes. Based on Company Exhibit JTW-2, page 4.5, I determined the actual average percentage interest expense paid by the Company on the Utah customer service deposits during fiscal year 2004. I then applied this average percentage to my recommended increase in customer service deposits, resulting in a $212,534 increase in interest expense above the amount included in the Company's filing. This adjustment is also included on CCS Exhibit 1.8.

<u>Cash Working Capital</u>

Q. PACIFICORP UPDATED ITS LEAD/LAG STUDY SINCE THE LAST RATE CASE. HAVE YOU REVIEWED THIS STUDY?

A. Yes. As a result of a Stipulation in the prior rate case, Docket No. 03-2035-02, PacifiCorp filed a new lead/lag study in May 2004. The revised lead/lag study results in 8.07 net lag days, which PacifiCorp applies to its average daily cost of service to determine its cash working capital request. The study was conducted using the fiscal year ended March 31, 2003, with a few exceptions. PacifiCorp's filing, at Exhibit JTW-1, page 2.32, reflects a cash working capital request of $24,818,020.

Q. BASED ON YOUR REVIEW OF THE LEAD/LAG STUDY, ARE YOU RECOMMENDING ANY MODIFICATION TO THE NET LAG DAYS PROPOSED BY PACIFICORP?

A. Yes. For determining the expense lag, PacifiCorp deviated from use of the fiscal year ended March 31, 2003 for determining the income tax lag days and instead used data for the period ended March 31, 2001. The lead/lag study indicates that the reason for using March 2001 information is that "…fiscal year 2003 federal and state income tax returns were not complete as of November 2003, and may very well result in a taxable net operating loss with no tax liability due." The study also indicates that fiscal year 2002 was a taxable net operating loss year and indicates that: "The main reason for the taxable loss, or possibility thereof, in those years results from bonus depreciation deductions that are currently scheduled to sunset in December 2004…Therefore neither of these two fiscal years is representative of a normal tax year." The tax data used by the Company in its analysis, based on data for the period ended March 31, 2001, results in income tax lag days of 17.1 days for federal income taxes and 21.16 days for state income taxes. The Company's use of these low lag days results in reducing the overall net expense lag days, which likewise results in increasing the cash working capital calculation. It is inappropriate for PacifiCorp to use these income tax lag days in determining the overall net lag days in its lead/lag study analysis and for determining the cash working capital requirement in this case.

Q. WHY IS IT INAPPROPRIATE FOR THE COMPANY TO USE ITS PROPOSED INCOME TAX LAG DAYS IN DETERMINING THE APPROPRIATE CASH WORKING CAPITAL IN THIS CASE?

A. Committee witness Michael Arndt's testimony addresses the Company's recent history with regards to the payment of income taxes to the federal government as well as projected payments for the future test year in this case. Based on information presented in Mr. Arndt's testimony, it is not appropriate to factor in such a short number of income tax expense lag days considering the level of cash payments to be paid to the federal government. If anything, an extremely long number of expense lag days exist for income taxes, not the short period being used by the Company in its lead/lag study. Consequently, I recommend that the impact of the tax lag days be removed from PacifiCorp's lead/lag study in determining the net lag days.

Q. WHAT ADJUSTMENT IS NEEDED TO REMOVE THE IMPACT OF THE INCOME TAX LAG DAYS IN DETERMINING CASH WORKING CAPITAL?

A. Using page 2.6.2 of the Company's lead/lag study, removal of the impact of the income tax lag from the calculation of the total expense lag results in increasing the expense lag days from 36.76 days to 37.15 days. This results in decreasing the net lag days from 8.07 to 7.67 days, a reduction of 0.31 days. On CCS Exhibit 1.9, I apply the 0.31 reduction in days to PacifiCorp's proposed average daily cost of service, resulting in a $957,162 reduction to cash working capital.

Q. HAVE YOU ALSO PREPARED AN EXHIBIT REFLECTING THE IMPACT OF THE COMMITTEE'S RECOMMENDED ADJUSTMENTS TO OPERATING EXPENSE ON CASH WORKING CAPITAL?

A. Yes. On CCS Exhibit 1.10, I determine the impact on cash working capital resulting from the Committee's recommended adjustments to operating expenses using my recommended net lag day of 7.67 days. In flowing the Committee's recommended adjustments through the jurisdictional allocation model, I revised the cash working capital net lag days to my recommended 7.67 days.

Q. IS THE COMMITTEE RECOMMENDING ANY ADDITIONAL ADJUSTMENTS TO THE COMPANY'S WORKING CAPITAL REQUEST?

A. Yes. The adjustments addressed above pertain to cash working capital. Committee witness Michael Arndt recommends an additional adjustment to cash working capital associated with long-term debt, the impact of which is reflected on CCS Exhibit 1.11, reducing cash working capital by $12,949,606 on a Utah basis. In flowing the Committee's recommended adjustments through the jurisdictional allocation model, I inserted the necessary calculation as an additional item in the cash working capital area of the report. This adjustment is shown on CCS Exhibits 1.1 and 1.2, on page 32, line 2219. In his testimony, Committee witness Helmuth Schultz addresses the remaining components of the Company's working capital request.

OPERATING INCOME (EXPENSE AND REVENUE) ADJUSTMENTS

Q. PRIOR TO DISCUSSING YOUR RECOMMENDED EXPENSE AND REVENUE ADJUSTMENTS TO OPERATING INCOME, DO YOU HAVE ANY CONCERNS RELATING TO HOW THE COMPANY PUT TOGETHER THE EXPENSE AREA OF THE FILING?

A. Yes. I believe it is important that the Commission understand how the Company's filing with regards to non-labor operating and maintenance expenses and administrative and general expenses (OMAG expenses) was put together in deriving PacifiCorp's requested fiscal year 2006 expense levels. The method used by the Company in determining the projected fiscal year 2006 OMAG expenses raises a number of concerns that has lead me to recommend several adjustments, such as my escalation adjustment and adjustment for scrap sales.

Q. PLEASE CONTINUE.

A. The starting point in determining the projected fiscal year 2006 expense levels was to remove labor costs from the fiscal year 2004 (historic test year) booked OMAG expenses, by FERC account. This is shown on Company Exhibit JTW-1, section 4. The Company then made several specific adjustments to the resulting non-labor fiscal year 2004 expense levels. Costs in Accounts 501 – Fuel Related, 503 – Steam from Other Sources, 547 – Fuel Expense, 555 – Purchased Power and 565 – Wheeling Expense were separately adjusted as part of the Company's Net

Power Cost adjustments in Section 5 of Company Exhibit JTW-1. For the remaining power supply expense accounts, FERC accounts 500 through 557, and the administrative and general expense accounts, FERC accounts 920 through 935, the Company then applied various escalation factors for both fiscal year 2005 and fiscal year 2006 to determine a projected fiscal year 2006 non-labor expense level. The escalation factors used by PacifiCorp will be addressed later in my testimony.

For PacifiCorp's Transmission Expense accounts (FERC Accounts 560 through 573, excluding account 565), Distribution Expense accounts (FERC Accounts 580 through 598), Customer Accounting Expense accounts (FERC Accounts 901 through 905), and Customer Service Expense Accounts (FERC Accounts 907 through 916), the fiscal year 2006 amounts are based on the fiscal year 2006 amounts contained in the "2004 Power Delivery Business Plan" dated June 16, 2004. In other words, FERC accounts 560 through 916, with the exception of Account 565, are based on a plan prepared by the Power Delivery group of the Company. The Company's filing, as shown in Exhibit JTW-1, Section 4.1, does reflect the application of the inflation factors to these accounts, but it is the 2004 Power Delivery Business Plan that is actually used to project (inflate) these accounts. It is important to note that the amounts contained in the 2004 Power Delivery Business Plan, as revised and submitted June

16, 2004, are higher overall than the fiscal year 2006 budget for the Power Delivery group.

After the fiscal year 2006 non-labor costs were projected by the Company, as discussed above, the filing then adds the projected fiscal year 2006 labor costs by FERC account and allocation factor. The Company then made several additional adjustments in Section 4 of its filing for specific projected cost increases and to reflect its projected fiscal year 2006 net power costs.

Mapping to FERC Accounts

Q. DO YOU HAVE ANY MAJOR CONCERNS WITH THE COMPANY'S SAP ACCOUNTING SYSTEM AND MAPPING OF COSTS FROM SAP ACCOUNTS TO FERC ACCOUNTS?

A. Yes. Several years ago, the Company began using the SAP accounting system. The cost of this system, along with the timing of the inclusion of the SAP system in plant in service, was an issue in prior PacifiCorp rate cases. In the filing, the Company has made some major changes to how costs are mapped from its SAP accounts to FERC accounts. These "mapping" changes impact both the comparability of PacifiCorp accounts from year-to-year and the comparability of PacifiCorp expense amounts to other electric utilities. Stated differently, these mapping changes make annual comparisons of account balances under normal regulatory accounting nearly impossible and make comparisons on a FERC account basis to other electric utilities invalid.

In data request CCS 6.11, the Company was asked what factors caused significant variances in costs recorded in 15 different FERC accounts between the fiscal year ended March 31, 2003 and the fiscal year ended March 31, 2004. According to the Company's response, in the fiscal year ended March 31, 2004, the Company changed the mapping of SAP accounts to FERC accounts for the Power Delivery business unit. This re-mapping of the SAP accounts resulted in a significant shifting of costs among functional groups in the fiscal year ended March 31, 2004. The shifts were primarily from administrative and general expenses to distribution operations and customer accounts.

The Company also changed how labor cost pools for distribution employees were charged. According to the Company's response to CCS 6.11, this impacts the allocation of costs such as "…labor, benefits, taxes, materials, supplies, vehicle costs and corporate assessments such as I.T., facilities, and shared services."

According to the same response, the Company has also re-mapped payroll taxes and vehicle depreciation in the FERC ledger. This results in payroll taxes and vehicle depreciation expense now being mapped to numerous OMAG expense accounts instead of being recorded in the appropriate FERC accounts.

Of major concern is that the OMAG expenses as reflected in fiscal year 2006 in the Company's filing is not in compliance with the FERC Uniform System of Accounts (USOA). While the Company's filing does show the amounts by FERC account, the Company's method of allocating payroll taxes, vehicle depreciation and employee pension and benefit costs to numerous FERC accounts based on the allocation of labor/payroll dollars to those accounts is not consistent with the USOA. Under the USOA the expense portion of payroll taxes is charged to Account 408 and vehicle depreciation is booked to Account 403. Additionally, under the USOA, the non-capitalized portion of employee pensions and benefits are to be recorded in Account 926. The result is that the final projected fiscal year 2006 OMAG expense accounts included in the filing is not comparable to other electric utilities. Under the Company's new methodology of mapping employee benefits, payroll tax and vehicle depreciation costs to numerous FERC accounts, it is not possible to identify specific cost items for these types of costs absent significant input from the Company. Thus, the methodology used by the Company in fiscal year 2006 causes the Company's presentation by account to shift further away from FERC accounting standards.

<u>Escalation Factors</u>

Q. YOU PREVIOUSLY INDICATED THAT THE COMPANY'S FILING INCLUDES THE APPLICATION OF ESCALATION FACTORS TO THE COSTS RECORDED IN CERTAIN FERC POWER SUPPLY EXPENSE ACCOUNTS AND ADMINISTRATIVE AND GENERAL EXPENSE ACCOUNTS DURING FISCAL YEAR 2004. WHAT FACTORS DID THE COMPANY USE AND WHAT WAS THE SOURCE OF THOSE FACTORS?

A. PacifiCorp escalated the non-labor costs in certain accounts using functional specific escalation factors (called DRI Indexes) prepared by Global Insight's Utility Cost Information Service and contained in Global Insight's Power Planner for the first quarter of 2004. The Power Planner provides projected indexes at either the individual FERC account level or based on the weighted FERC level indexes for major FERC expense categories. In its filing, PacifiCorp uses the DRI indexes based on the weighted FERC level indexes by major FERC expense categories as opposed to the individual FERC account level. The factors used exclude labor expenses and are based on materials and supplies. In determining the weighting when combining the individual FERC-level indexes into the FERC level major expense category indexes, Global Insight uses a publication based on statistics of privately owned electric utilities. PacifiCorp weighted the annual calendar year factors to estimate fiscal year factors in its analysis.

Q. DO YOU RECOMMEND THAT THE FACTORS PROPOSED BY PACIFICORP BASED ON THE PRICE INDICES DETERMINED BY GLOBAL INSIGHT BE ACCEPTED IN THIS CASE?

A. No, I do not. As previously discussed, PacifiCorp's re-mapping of SAP accounts to different FERC accounts between periods results in non-labor costs in FERC accounts shifting significantly from year to year. This results in the FERC accounts not being comparable across periods. Consequently, I do not recommend basing the inflation factors (or price indices) on a methodology in which the allocation factors are specific to individual FERC accounts or major FERC categories in PacifiCorp's case. The re-mapping that occurred in fiscal year 2004 resulted in costs that were previously mapped to FERC A&G accounts being re-mapped to FERC distribution accounts. Additionally, the inflation factors used were based on study results from the first quarter of 2004, which would now be considered stale.

Q. ARE THERE ANY ADDITIONAL REASONS THAT THE COMPANY'S PROPOSED PRICE INDICES SHOULD NOT BE USED FOR PROJECTING FISCAL YEAR 2006 NON-LABOR EXPENSES?

A. Yes. In projecting the fiscal year 2006 non-labor expense levels for certain FERC accounts in the filing, the Company has applied escalation factors to both fiscal year 2005 and fiscal year 2006. Based on information reviewed in this case, the application of escalation factors in fiscal year 2005 will likely not be reflective of actual circumstances for PacifiCorp.

Q. PLEASE EXPLAIN?

A. According to the Company's performance reports for the current fiscal year (FY '05), PacifiCorp is implementing additional budget efficiencies and initiatives that were not included in its budget for the current fiscal year. According to the Company's response to CCS 23.18(a), one of the reasons for the implementation of the additional budget efficiencies and initiatives is to help mitigate "…the effects of reduced hydro resources, lower thermal availability, mild weather, plus the identification of initiatives to address a task in the original budget." The response states that the aim of the post-budget reviews was to "… identify and track potential improvements, whilst at the same time, ensuring the protection of customer service, reliability, safety, technical training for craft personnel and GAAP compliance." The response also indicates that many additional budget efficiencies and initiatives have either been implemented or adopted in principle.

In response to CCS 23.18(b), the Company listed thirty-three documents pertaining to budget efficiencies and initiatives that it considered highly confidential that would be made available for review. While some of the documents have been revised to a confidential level, the listing of the 33 items was not classified as confidential. The list of budget efficiency and initiative documents includes such items as “PD Squeeze: PD Worksheet: ‘Budget Levers Phasing $7.5 Million OMAG’”, CEO Department savings worksheet, RTO cost savings, communication department savings, risk management department savings, insurance department savings, travel policy enhancements, and various recruiting and hiring assumption initiatives, among others.

BEGIN CONFIDENTIAL

END CONFIDENTIAL

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE APPLICATION OF COST ESCALATION FACTORS IN THIS CASE?

A. Considering the level of budget initiatives and efficiencies being implemented by PacifiCorp during the current fiscal year, I recommend that no inflation factor be applied for fiscal year 2005 and an inflation factor different than those proposed by PacifiCorp be used for fiscal year 2006.

Q. YOU PREVIOUSLY ADDRESSED WHY THE COMPANY'S PROPOSED PRICE INDICES BASED ON THE GLOBAL INSIGHT POWER PLANNER SHOULD NOT BE USED. WHAT ESCALATION FACTOR DO YOU RECOMMEND BE USED FOR FISCAL YEAR 2006.

A. I recommend that a more general inflation factor be used as opposed to factors specific to major FERC account groups for the reasons previously discussed. I also recommend that a more current inflation factor be used as opposed to factors that were prepared over six months ago.

The Blue Chip GDP price index has been used regularly in cases in Connecticut, which has a well-established history of using future test years in general rate proceedings. As of November 2004, the Blue Chip GDP price index was 2.1% for 2005 and 2.2% for 2006. If these factors are pro-rated to a fiscal year basis (i.e, twelve-months ending March 31, 2006), the result is a fiscal year 2006 factor of 2.13%. Therefore, I recommend using the most recent Blue Chip GDP price index pro-rated to the 2006 test year, which results in a 2.13% inflation factor.

Q. HAVE YOU PREPARED AN EXHIBIT THAT SHOWS THE IMPACT OF YOUR ESCALATION RECOMMENDATIONS ON PACIFICORP'S PROJECTED FISCAL YEAR 2006 EXPENSES?

A. Yes. On CCS Exhibit 1.12, I first started with the non-labor fiscal year 2004 costs for the FERC accounts in which PacifiCorp has proposed to base on escalated amounts. I then apply a 0% escalation factor for fiscal year 2005 and my recommended 2.13% escalation factor for fiscal year 2006. I then compare my recommended escalated amounts to the amounts proposed by PacifiCorp. As shown on the exhibit, the result is a recommended reduction to future test year expenses of $5,683,214 on a total Company basis and $2,608,354 on a Utah basis.

Q. HAVE YOU REFLECTED THE IMPACT OF OTHER NON-LABOR RELATED ADJUSTMENTS TO THESE FERC ACCOUNTS PROPOSED BY EITHER YOU OR OTHER COMMITTEE WITNESSES ON THIS EXHIBIT?

A. No. For specific non-labor related adjustments to these FERC accounts, I remove the impacts of inflation on the exhibits for each of those adjustments as opposed to flowing them through CCS Exhibit 1.12.

<u>Scrap Sales</u>

Q. DOES THE METHODOLOGY EMPLOYED BY PACIFICORP IN DETERMINING THE PROJECTED FISCAL YEAR 2006 OMAG

EXPENSES CAUSE ANY PROBLEMS THAT NEED TO BE CORRECTED?

A. Yes. During the historic fiscal year 2004, the Company realized $1,856,649 in revenues from scrap sales, which it booked to numerous FERC expense accounts. For the current fiscal year 2005, through the date of the response to CCS data request 21.3 (October 29, 2004), the Company had already realized $1,358,881 in scrap sales. In data request CCS 21.3, the Company was asked to provide the total amount of revenues received from scrap sales for each of the last three fiscal years, fiscal year 2005 to date and as projected for fiscal year 2006. The Company was asked to provide the amounts on a total Company and a Utah basis and to identify the FERC accounts the sales are reflected in. In its response, the test year amount of $1,929,581 (total Company basis) identified by the Company was based on the amounts booked in fiscal year 2004 by FERC account as inflated by the Company's proposed fiscal year 2005 and fiscal year 2006 escalation factors. However, the way the Company's filing is put together, the $1,929,581 figure is not the actual amount included in the 2006 test year for scrap sales.

Q. PLEASE EXPLAIN.

A. In fiscal year 2004, $1,135,765 of the $1,856,649 in total scrap sales revenues were booked in FERC accounts 571, 592, 593, 594, 597, 598 and 903. These specific FERC accounts were included in the accounts that were revised to reflect the fiscal year 2006 amounts presented in the Power Delivery Business Plan, rather than the fiscal year 2004 escalated amounts. Therefore, only $720,884, or 39%, of the actual fiscal year 2004 scrap sales revenue was included in costs that were escalated to fiscal year 2006.

Q. DOES THE POWER DELIVERY BUSINESS PLAN OMAG EXPENSES INCLUDE ANY OFFSETS FOR REVENUES FROM SCRAP SALES?

A. As a supplemental response to data request CCS 6.7, the Company provided a complete copy of the 2004 Power Delivery Business Plan, which is 162 pages plus several attached appendices. I was unable to identify any scrap sales revenue offsets to OMAG expenses in the fiscal year 2006 amounts in the plan. Based on the information provided, it does not appear that revenues from scrap sales are included. If they are included, they are combined with other numbers in the plan and cannot be readily identified from the information provided.

Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO THE FUTURE TEST YEAR FOR REVENUES FROM SCRAP SALES?

A. Yes. As shown on CCS Exhibit 1.13, I identified the actual fiscal year 2004 scrap sales revenues recorded in the FERC accounts that were impacted by the Company's Power Delivery Plan adjustment. I then apply my recommended escalation factors of 0% for FY '05 and 2.13% for FY

'06, resulting in my recommended increase in scrap sales revenues of $1,159,957, which is $713,284 on a Utah basis. This revenue increase reflects the full amount of historic fiscal year 2004 scrap sales, as inflated using my recommended escalation factors.

<u>CSS/SAP Life Extension</u>

Q. BOTH THE CSS AND THE SAP COMPUTER SOFTWARE SYSTEMS HAVE BEEN ISSUES IN PRIOR PACIFICORP CASES. DO THE ISSUES OF THE CSS AND SAP SYSTEMS NEED TO BE REVISITED IN THE CURRENT CASE?

A. Yes. Specifically, the amount of amortization expense included in rates for these two systems needs to be addressed. PacifiCorp's SEC Form 10-Q for the quarter ended September 30, 2004, under Note 1 to the condensed consolidated financial statements, indicates:

> "During the six months ended September 30, 2004, PacifiCorp changed the estimated average lives of certain computer software systems to reflect operational plans. This change will reduce amortization expense by approximately $12.9 million annually on existing computer software systems, with an annual impact to net income of approximately $8.0 million."

Q. DO YOU HAVE ANY ADDITIONAL INFORMATION REGARDING THE CHANGE IN ESTIMATED AVERAGE LIVES OF THESE COMPUTER SOFTWARE SYSTEMS?

A. Yes. In response to CCS 23.22 the Company provided a copy of an internal correspondence addressing the extension of the estimated lives for CSS and SAP systems. The response also indicated that it was determined that the systems will provide "significant economic benefits to the company and used and useful assets through or beyond March 2014." As a result, the lives for both of the software systems were extended to March 2014, effective April 1, 2004, which is the first day of FY '05. The response indicated that the annual cost savings are approximately $12.8 million, with $6.3 million resulting from the estimated life extension to the CSS system and $6.5 million resulting from the estimated life extension to the SAP system. Thus, the annual amortization expense associated with these two systems will be approximately $12.8 million lower beginning in fiscal year 2005.

Q. HAVE THE ESTIMATED ANNUAL AMORTIZATION EXPENSE REDUCTIONS FOR THESE TWO SYSTEMS BEEN REFLECTED IN THE COMPANY'S FILING?

A. In response to CCS 23.22, the Company states: "These savings are reflected in amortization expense in the FY 2006 test year." However, based on my review of workpapers provided in the Company's filing, it does not appear that the savings have been reflected in the test year.

Q. PLEASE EXPLAIN.

A. The depreciation and amortization expense section of the Company's filing, specifically Exhibit JTW-1, Page 6.0, states that the forecasted 2006 amortization expense "…was calculated by applying a composite amortization rate to the forecasted average intangible plant balances…" Page 6.9 of JTW-1 provides the composite rates used in the depreciation and amortization calculations. The intangible plant amortization rate used is shown as 7.7795%, which ties into the amortization expense calculations presented by the Company. Page 6.9 specifically identifies the composite rates provided as "MAR 04 Rate." There is no indication that the intangible plant amortization rate being used is not based on the March 2004 composite rate. Additionally there was no testimony, exhibits or workpapers provided with the Company's filing demonstrating that an adjustment or revision was made to the composite rate to reflect the impact of the change in CSS and SAP software system lives. The only information provided on the amortization rate was the composite rate provided, which is identified as a March 2004 composite rate. According to responses provided by the Company, the change in lives for the CSS and SAP software was effective April 2004, which is after the March 2004 date identified as the composite rate used.

Q. WHAT ADJUSTMENTS NEEDS TO BE MADE TO THE COMPANY'S FILING TO REFLECT THE IMPACT OF THE CHANGE IN

AMORTIZATION EXPENSE FOR THE CSS AND SAP SYSTEMS IN FISCAL YEAR 2006.

A. As shown on CCS Exhibit 1.14, amortization expense needs to be reduced by $12,816,655 on a total Company basis and $5,528,840 on a Utah basis. Additionally, accumulated amortization should be reduced by $19,224,983 on a total Company basis and $8,293,260 on a Utah basis to reflect the impact on the average future test year accumulated amortization.

<u>Capital Lease Interest</u>

Q. THE COMPANY'S FILING INCLUDES AN ADJUSTMENT TITLED "CAPITAL LEASE INTEREST". PLEASE DISCUSS THIS ADJUSTMENT.

A. The Company's adjustment, on page 4.14 of Exhibit JTW-1, describes this adjustment as necessary to reflect the interest component of the capital lease payments in order to reflect the full capital lease expense in the revenue requirement calculations. The adjustment indicated that the principal portion of the lease payment was recorded in account 930, but that the interest component is recorded in Account 431 so it does not impact operating costs. However, when questioned on the adjustment in data request CCS 24.6, the response indicated that under the Company's mapping of SAP accounts to FERC accounts, the interest component of the capital lease payments have been applied to above the line FERC accounts. The response also indicated that upon further review, the Company has determined that the interest component of the capital leases are in fact included in the result of operations in the filing, making its adjustment for this item no longer necessary. In its response to CCS 24.6, the Company has agreed to remove the adjustment.

Q. HAVE YOU REFLECTED THE REMOVAL OF THIS COMPANY ADJUSTMENT IN YOUR EXHIBITS?

A. Yes. The reversal of the Company's adjustment is presented on CCS Exhibit 1.15, resulting in a reduction to expenses of $3,246,000 on a total Company basis and $1,350,619 on a Utah allocated basis.

<u>SO2 Emissions Allowances</u>

Q. THE COMPANY IS RECOMMENDING A CHANGE IN HOW THE REVENUES FROM THE SALES OF SO2 EMISSIONS ALLOWANCES ARE REFLECTED IN DETERMINING RATES AS COMPARED TO HOW THE REVENUES HAVE BEEN TREATED IN PRIOR UTAH RATE CASES. PLEASE DISCUSS THE COMPANY'S PROPOSED CHANGE IN METHODOLOGY.

A. In prior cases, the level of emissions allowance sales revenue was based on a tracking of the actual annual sales revenue with a "rolling" four-year amortization of the actual sales revenues. This method has been followed consistently since Docket No. 97-035-01, wherein it was approved by the

Commission in its rate case order dated February 26, 1999. This method was continued and uncontested in Docket Nos. 99-035-10, 01-035-01 and 03-2035-02. This methodology was devised and implemented mainly due to the fact that the annual revenues from the sales of emissions allowances have fluctuated from year to year.

The four-year amortization method has benefited both shareholders and ratepayers in the past. From shareholders' perspective, it ensures that base rates do not include SO2 emissions allowances sales revenues that may be higher than normal, ongoing levels. It also ensures that ratepayers receive the revenue benefit of emissions allowance sales, and that revenues are not included in rates in any given year based on a lower revenue level that may not be reflective of normal, ongoing levels. In the current case, the Company is proposing that the sales of SO2 emissions allowances remain at the amount actually recorded on the books during the historic fiscal year 2004 period.

Q. WHY IS PACIFICORP RECOMMENDING THE CHANGE IN METHODOLOGY OF RECOGNIZING REVENUES FROM THE SALES OF SO2 EMISSIONS ALLOWANCES IN THIS CASE?

A. According to the Direct Testimony of PacifiCorp witness J. Ted Weston, at page 14, the Company has only sold the amount of emissions allowances mandated by the EPA, which has been under $600,000 per year since

2002. He also indicates that the Company plans to continue with this level of sales in the future. The fiscal year 2004 level of sales was $585,037, which the Company claims is consistent with the prior two years. Consequently, the Company proposes that the 2006 test year sales revenue level be based on the fiscal year 2004 results, apparently because it no longer anticipates the level of sales to fluctuate as it has in the past.

Q. DO YOU AGREE THAT THE FUTURE TEST YEAR REVENUES FROM THE SALE OF SO2 EMISSIONS ALLOWANCES SHOULD BE INCLUDED BASED ON THE FY ’04 LEVEL OF $585,037?

A. No, I do not. According to the response to CCS 10.11, the amount of revenues from the sale of SO2 emissions allowances for FY ’05 year to date has been $908,181. The response to DPU data request 3.20 indicates that the Company’s projects revenues of $1,000,000 from the sales of emissions allowances in fiscal years 2006 and 2007. Clearly the historic fiscal year 2004 level is not reflective of recent revenue levels or projected revenue levels from the sales.

Q. WHAT IS YOUR RECOMMENDATION?

A. As shown on CCS exhibit 1.16, I recommend that the well-established methodology of amortizing the sales revenue over a four-year period for purposes of setting a normalized revenue level to include in rates be continued, with the unamortized balance being reflected as an offset to rate base (which is also consistent with past treatment). As shown on CCS Exhibit 1.16, revenues should be increased by $138,291 ($56,930 Utah basis) and rate base should be reduced by $1,240,143 ($516,008 Utah basis) net of accumulated deferred income taxes to reflect the continuation of this methodology.

If the Commission decides to discontinue the four-year amortization methodology, then fiscal year 2006 revenues should be increased by $414,963 ($170,827 Utah basis) to reflect the projected fiscal year 2006 revenues of $1 million instead of the actual fiscal year 2004 revenues of $585,037.

Plant Addition Cost Savings

Q. DO ANY OF THE COMPANY'S PROJECTED ADDITIONS TO PLANT IN SERVICE THAT YOU HAVE NOT RECOMMENDED BE REMOVED IN THE FUTURE TEST YEAR RESULT IN COST SAVINGS FOR WHICH THE IMPACT HAS NOT YET BEEN REFLECTED IN THE FILING?

A. Yes. Included in the Company's projected additions to plant in service for 2005 and 2006 are three projects in which the Company plans to purchase and install bottom ash submerged drag chain conveyors to replace existing bottom ash systems. These projects are included in the filing for Hunter Unit 1 and Jim Bridger Units 2 and 4. In response to CCS

Data Request 6.32, the Company provided the expenditure requisitions for each of these projects. According to the information provided, the Company has estimated operating and maintenance cost savings in fiscal year 2006 of $487,000 for Hunter Unit 1, $628,000 for Jim Bridger Unit 4 and $377,000 for Jim Bridger Unit 2. The level of projected savings in fiscal year 2006 for Jim Bridger Unit 2 is smaller because that project is not expected to be completed until fiscal year 2006. Therefore, a full year of cost savings will not be realized in the 2006 test period.

Q. DO YOU RECOMMEND AN ADJUSTMENT BE MADE TO REFLECT THESE COST SAVINGS?

A. Yes. Since the projects are included in plant in service as well as depreciation expense, the associated cost savings should also be reflected. As shown on CCS Exhibit 1.17, PacifiCorp's projected future test year expenses should be reduced by $1,492,000 ($625,269 Utah basis).

<u>Pension Expense</u>

Q. THE COMPANY'S FILING INCLUDES A SIGNIFICANT PROJECTED INCREASE FOR PENSION EXPENSE FROM FISCAL YEAR 2004 TO THE 2006 TEST YEAR. IN YOUR OPINION, IS THE COMPANY'S PROJECTED INCREASE IN PENSION COSTS SUPPORTED IN THIS CASE?

A. No, definitely not. The actual amount of FAS 87 pension expense for fiscal year 2004 for PacifiCorp was $18,906,000, $14,772,612 of which pertains to electric operations. This amount is based on a full actuarial study. In its filing, PacifiCorp has projected that the $14,772,612 fiscal year 2004 pension expense will increase to $31,477,807 in fiscal year 2005 and to $41.6 million in the fiscal year 2006 test year. This results in an estimated $26.8 million increase in pension expense factored into the Company's rate case filing. Despite the fact that PacifiCorp's proposed increase in pension expense is both large and based on projections, the Company has provided minimal support for this significant adjustment. Furthermore, several of the assumptions used by the Company in estimating its projected test year pension expense are inappropriate and inaccurate.

Q. WHAT LEVEL OF SUPPORT HAS THE COMPANY PROVIDED TO SUBSTANTIATE ITS CLAIMED $26.8 MILLION INCREASE IN PENSION EXPENSE?

A. In Exhibit DJR-2, a two page exhibit, PacifiCorp provided its projected fiscal year 2005 and 2006 pension expense calculations on an electric operations basis, totaling $31.5 million and $41.6 million, respectively. DPU data request 3.29 asked the Company to provide a copy of its actuary's (Hewitt Associates) SFAS 87 actuarial calculations that support the Company's pension expense for the forecast test period. One page was provided in the response showing how the Company went from its actual fiscal year 2004 expense level to its projected fiscal year 2006 expense level.

In CCS data request 3.45, PacifiCorp was asked to "…provide all correspondence to and from the Company's actuaries (Hewitt Associates) regarding the projected 2005 and 2006 FY pension expense included in the Company's filing." The Company was also asked for the information provided by Hewitt Associates and used in the Company's filing to be in the most detailed format available. The entire response provided by the Company consisted of three one-page attachments.

The first attachment is a one-page document titled "PacifiCorp Pension Fiscal Year 2005 Expense – US GAAP" and provides a breakdown of the FAS 87 pension expense by component (i.e., service cost, interest cost, expected return on plan assets, and amortization of unrecognized net transition obligation, unrecognized prior service costs and unrecognized net loss) as projected for fiscal year 2005, as well as providing a projected Company contribution amount and market-related value of plan assets.

The second attachment shows an allocation of the estimated fiscal year 2005 pension expense to mining operations, non-regulated operations and electric operations. It is worth noting that while the Company has projected the electric operations portion of the pension expense to increase from $14.8 million from fiscal year 2004 to $31.5 million in fiscal year 2005, it has only projected that the amount being allocated to mining and non-regulated operations will increase from $4.1 million to $4.3 million over the same period.

The third attachment provided by the Company purportedly shows how the Company adjusted its projected fiscal year 2004 pension expense amount of $14.8 million to its requested test year level of $41.6 million. This attachment was already provided as page 2 of Exhibit DJR-2.

The response also indicated that if additional correspondence is located, the response will be supplemented. During my on-site audit at the Company's offices, I inquired whether the information provided in the data response was going to be supplemented. However, no additional information has been provided. It is very surprising that no electronic or written correspondence between the Company and its actuaries was maintained to support the Company's claim for a $26.8 million increase in pension expenses. At a minimum, any instructions or specific requests to the Company's actuaries regarding the calculations should have been retained. In other cases in which I have participated in which future test years have been used, very detailed information and correspondence between the Company and its actuaries was provided.

Q. IS THE PROJECTED FISCAL YEAR 2006 PENSION EXPENSE PROPOSED BY THE COMPANY BASED ON A FULL ACTUARIAL STUDY?

A. No. In fact, the Company still does not have a full actuarial study for its fiscal year 2005 pension expense. The Company was asked in CCS data request 3.44 to provide the two most recent actuarial reports conducted for the Company. In its response, the most recent one provided was the one supporting the fiscal year 2004 pension costs, which is the January 1, 2003 report with a cover letter dated September 2003. The response indicated that the January 1, 2004 report is not complete and will be provided when available. It is the January 1, 2004 report that will be used for determining the final level of pension expense to be booked in the current fiscal year (2005).

Since the prior report had a cover page indicating the month of September 2003, I called the Company in early November to inquire about the status of the current year actuarial report. I was informed that it would not be completed until about mid-December. As the current fiscal year actuarial report is not yet complete, the expense included by the Company as the estimate for the fiscal year 2005 pension expense is not based on a full actuarial report. Apparently it is based on an actuarial estimate provided by the Company's actuary, Hewitt Associates, but no correspondence or details have been provided to let the parties know what type of instructions, assumptions, etc., Hewitt was asked to use in preparing this estimate.

The only information provided regarding the assumptions included in determining the fiscal year 2005 pension expense estimate is what can be derived from Company witness Daniel J. Rosborough's testimony and his Exhibit DJT-2. This essentially consists of the assumption that the discount rate used will decline from 6.75% in FY '04 to 6.25% for FY '05, the expected return on assets assumption is 8.75% for FY '05, and that it factors in the impact of continuing the smoothing in of losses incurred in 2000 through 2002. Mr. Rosborough's testimony does not discuss if there were asset gains in 2003 and if those gains, if any, are considered in projecting the fiscal year 2005 pension expense. His testimony also does not address any instructions or directives provided by the Company to Hewitt Associates for purposes of projecting the estimates included in the case.

Q. YOU PREVIOUSLY INDICATED THAT IN ADDITION TO NOT PROVIDING A REASONABLE LEVEL OF SUPPORT, THE AMOUNTS PROPOSED BY THE COMPANY FOR FISCAL YEAR 2006 ARE INAPROPRIATE AND INACCURATE. PLEASE EXPLAIN.

A. In determining the amount of increase needed to go from its projected fiscal year 2005 pension expense to the test year expense level, the Company made the assumption that it would only earn a 4% rate of return on its investments in calendar year 2004 and 8% in calendar year 2005. The projected fiscal year 2006 pension expense results from factoring in additional actuarial losses for 2004 and 2005 as the assumed returns of 4% and 8% are below the actuarial assumption for the expected long-term return on assets of 8.75%. Company Exhibit DJR-2 indicates that its projected fiscal year 2006 costs includes the impact of a projected unfavorable asset return in fiscal year 2005. This is clearly inappropriate and is not known or measurable with any degree of certainty.

Q. WHY DID THE COMPANY ASSUME THAT IT WOULD ONLY EARN A RETURN OF 4% IN 2004 AND 8% IN 2005 ON ITS PENSION PLAN ASSETS, RESULTING IN AN ACTUARIAL LOSS FOR BOTH OF THOSE PERIODS?

A. According to Mr. Rosborough’s testimony, at page 5, the Company had only earned between zero and 1% on its assets for calendar year 2004 through May. It is on this basis that the Company assumed a 4% return for calendar year 2004 and 8% for calendar year 2005. According to the Company's response to CCS data request 3.46, as of June 30, 2004, only 1 month after May 2004, the Company had earned a return on its retirement plan assets of 3.9% in the calendar year to date.

Since the Company has already earned a 3.9% return in the first six months of 2004, it is not reasonable to assume that the total annual return will be only 4%. Clearly the Company's assumption of only a 4% return for all of 2004 and only 8% for 2005 is not appropriate. The Company has provided no information to justify its assumptions that it will earn less than the overall long-term expected return on its assets used in its actuarial assumptions of 8.75%.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARDS TO PENSION EXPENSE?

A. I recommend that the future test year pension expense be decreased from the $41.6 million proposed by PacifiCorp to the actual fiscal year 2004 expense level of $14.8 million. This recommendation is shown on CCS Exhibit 1.18 and results in a $9,243,610 reduction in projected pension expense on a Utah basis. This results in the future test year amount being based on the most recent known and measurable amount determined on a full actuarial study. The Company's projected fiscal year 2006 pension expense is not based on a full actuarial report, is not known or measurable, and contains inappropriate and inaccurate assumptions for which very little support or evidence has been provided.

<u>Regional Transmission Organization (RTO) West Expense</u>

Q. ON CCS EXHIBIT 1.19, YOU REMOVE NON-LABOR COSTS ASSOCIATED WITH RTO WEST FORMATION EFFORTS. PLEASE DISCUSS THIS ADJUSTMENT.

A. During fiscal year 2004, the Company incurred $2,863,589 of costs related to the RTO West formation efforts. This included $1,443,572 of non-labor related costs, such as employee travel costs, legal costs and consulting fees. Since 2004, RTO West formation efforts have slowed considerably, making the historic fiscal year 2004 level non-recurring. It is also my understanding that the cost level is not projected to be as high as it was in fiscal year 2004. Consequently, I recommend that the non-labor related costs be removed from the 2006 test year. As shown on CCS Exhibit 1.19, after application of my recommended escalation factors, expenses in the future test year should be reduced by $1,474,320 on a total company basis and $613,447 on a Utah basis.

Q. BY HOW MUCH HAS PACIFICORP ALREADY REDUCED THESE COSTS IN THE CURRENT FISCAL YEAR?

A. In the non-confidential listing of fiscal year 2005 budget efficiencies and initiatives, the Company identified three separate documents under Initiative 14: RTO Cost Savings.

******BEGIN CONFIDENTIAL******

******END CONFIDENTIAL******

<u>Sarbanes Oxley Compliance Costs</u>

Q. YOUR EXHIBITS INCLUDE AN ADJUSTMENT TO REMOVE EXTERNAL SARBANES OXLEY COMPLIANCE COSTS. WHY IS IT APPROPRIATE TO REMOVE COSTS ASSOCIATED WITH COMPLYING WITH SARBANES OXLEY?

A. The external costs incurred in fiscal year 2004 associated with the Company's compliance with Sarbanes Oxley requirements needs to be removed to eliminate a double-counting of compliance costs in the 2006 test year.

Q. PLEASE EXPLAIN.

A. During fiscal year 2004, the majority of the costs incurred by the Company for compliance with Sarbanes Oxley requirements was for contract labor with Ernst and Young, which is one of the largest Certified Public Accounting firms in the United States. According to the Company's response to CCS data request 23.1, this fiscal year 2004 contract labor cost was escalated into the future test year. The response also indicates that this contract labor has been replaced by an infrastructure of permanent employees. The Committee's recommended adjustment to internal labor costs, which is addressed by Committee witness Helmuth Schultz, allows for the Company's current employee compliment, plus additional employees beyond the current level. Consequently, the internal labor that has replaced the contract labor for Sarbanes Oxley compliance is already included in the future test year. Consequently, the fiscal year 2004 costs should be removed in order to prevent a double-counting of such costs. As shown on CCS Exhibit 1.20, future test year expenses should be reduced by $1,679,987 ($699,021 Utah basis).

<u>Tax Advisory Expense</u>

Q. WHAT IS THE PURPOSE OF YOUR ADJUSTMENT TO REDUCE TAX ADVISORY SERVICE COSTS?

A. During the historic test year ended March 31, 2004, the Company incurred $3,633,301 of costs associated with tax advisory services. The Company inflated this amount in its filing by applying its recommended escalation factors in the filing. According to the response to DPU data request 3.2, the Company forecasts that it will incur $3,040,000 in tax advisory service costs in the future test year. On CCS Exhibit 1.21, I reduce future test year expenses by $670,690 ($279,066 Utah) in order to reflect the projected test year costs.

Q. COMMITTEE WITNESS MICHAEL ARNDT IS RECOMMENDING AN ADJUSTMENT FOR CONSOLIDATED TAX SAVINGS. DOES HIS RECOMMENDATION IMPACT YOUR TAX ADVISORY SERVICES ADJUSTMENT?

A. If the Commission does not accept Mr. Arndt's consolidated tax savings adjustment, then I recommend the full amount of tax advisory services expense be removed from the future test year, resulting in an additional $3,040,000 reduction to test year costs. If Utah ratepayers do not receive the benefit of the tax advisory services being provided, they should not be included in rates.

<u>Property and Liability Insurance Expense</u>

Q. ARE THERE ANY PROBLEMS WITH THE PROPERTY AND LIABILITY INSURANCE EXPENSE CONTAINED IN THE COMPANY'S FILING FOR THE 2006 TEST YEAR?

A. Yes. There are several errors in the Company's filing with regards to the projected test year property and liability insurance expense in FERC accounts 924 and 925 that need to be corrected. The majority of the errors result from the use of incorrect amounts in the Company's adjustment to property and liability insurance expense. Additionally, the Company's projected property insurance premiums for the 2006 test year are overstated based on more recent information.

Q. HOW DID THE COMPANY DETERMINE THE TEST YEAR LEVEL OF PROPERTY AND LIABILITY INSURANCE EXPENSE CONTAINED IN ITS FILING?

A. On Company Exhibit JTW-1, Section 4.1, after an adjustment for environmental amortizations to Account 925, the Company applied an escalation factor for fiscal year 2005 to the level of expense recorded in Accounts 924 and 925. No escalation factor was applied for fiscal year 2006. The Company then increased the resulting balances to reflect a projected increase in costs in premiums and uninsured losses for property and liability insurance expense.

The Company's adjustment to property and liability insurance premiums and uninsured losses is contained on Exhibit JTW-1, page 4.13.1. On this exhibit, PacifiCorp calculated the difference between its projected fiscal year 2006 property and liability insurance premiums and uninsured losses and estimated fiscal year 2004 amounts. The main problem with the calculation is that the Company used estimated fiscal year 2004 amounts in the calculation instead of the actual amounts recorded on its books. The actual amounts for 2004 were higher than the estimated amounts contained in the calculation, particularly as the estimated amounts did not include the full amount of uninsured losses booked in fiscal year 2004 as a result of December 2003 winter storms in Utah and Oregon. The end result was an overstatement by the Company of its projected fiscal year 2006 property and liability insurance expense.

Q. AFTER THE ERRORS IN THE COMPANY'S CALCULATION METHODOLOGY ARE CORRECTED, DO ANY ADDITIONAL ADJUSTMENTS NEED TO BE MADE?

A. Yes. In determining the projected expense for property and liability insurance premiums for fiscal year 2006, the Company inflated its budgeted fiscal year 2005 insurance premium expense of $13,700,000 by 10%. This resulted in a projected fiscal year 2006 property insurance premiums expense of $15,070,000. However, property insurance premiums have declined this year. The actual fiscal year 2005 property insurance premiums have been considerably lower than what the Company had projected; this results in the fiscal year 2006 premiums also being overstated. According to the Company's response to CCS data request 24.8, the current forecast for fiscal year 2005 property insurance premium expense is $11,525,000, which is considerably lower than budgeted amount of $13,700,000 for the same period. Consequently, I recommend the most recent forecast of property insurance premiums expense of $11,525,000 be used for the test year.

Q. WHAT ADJUSTMENTS ARE NECESSARY TO CORRECT THE COMPANY'S ERRORS AND TO REFLECT YOUR RECOMMENDED TEST YEAR LEVEL OF PROPERTY INSURANCE PREMIUMS EXPENSE?

A. CCS Exhibit 1.22 presents my recommended adjustment to property insurance expense in account 924. This includes both property insurance premiums and uninsured losses. The adjustment corrects the errors contained in the Company's calculation methodology and reflects my recommendation that property insurance premiums be based on the most recent forecast amount for the current fiscal year. Since property insurance premium amounts have been declining, I recommend that the current year forecast be used for projecting the test year amount. As shown on the exhibit, property insurance expense in Account 924 should be reduced by $4,914,246 ($2,044,755 Utah).

As shown on CCS Exhibit 1.23, liability insurance expense in Account 925 should be reduced by $870,092 ($362,034 Utah) to correct the error in the Company's methodology. I have not recommended any revisions to the Company's proposed uninsured loss amounts for either property or liability insurance. Committee witness Helmuth Schultz is also recommending a separate adjustment for directors and officers liability insurance expense.

<u>New Process Support Costs</u>

Q. WOULD YOU PLEASE ADDRESS THE COMPANY'S ADJUSTMENT IN THE FUTURE TEST YEAR TITLED "NEW PROCESS SUPPORT COSTS"?

A. Yes. On Company Exhibit JTW-1, page 4.12, PacifiCorp increases future test year expenses in FERC Account 923 and 930 by $4,258,000 on a total Company basis for new process support costs. This is above and beyond the escalation adjustments applied by the Company to these accounts for fiscal years 2005 and 2006. According to page 4.12.1 of the exhibit, the $4,258,000 adjustment consists of $783,000 for information technology vendor rebate reductions, $1,975,000 for new system support and information technology security requirements, and $1,500,000 described as "CIO Contingency Funds." The only description provided in the filing in support of this $4,258,000 adjustment is that PacifiCorp continues to add software packages and systems and the adjustment reflects the additional costs required to support these systems.

Q. DID YOU ASK THE COMPANY TO PROVIDE ANY FURTHER INFORMATION IN SUPPORT OF THIS $4,258,000 ADJUSTMENT?

A. Yes. CCS data request 3.33 asked the Company to provide workpapers showing, in detail, how each of the three components of the adjustment were determined. The request also asked the Company to provide supporting contracts for projected costs and to explain what the CIO Contingency Fund was for.

Q. BASED ON THE INFORMATION RECEIVED IN THE COMPANY'S RESPONSE TO CCS DATA REQUEST 3.33, ARE YOU RECOMMENDING ANY REVISIONS TO THE REQUESTED COST INCREASE?

A. Yes. I recommend that the $783,000 adjustment associated with the projected reduction in information technology vendor rebates be removed and that the CIO Contingency Fund adjustment of $1.5 million be removed. The impact of these removals are reflected on CCS Exhibit 1.22, resulting in a $2,283,000 reduction ($949,927 reduction on a Utah basis) in the Company's adjusted future test year expenses. My recommendation still allows for an increase beyond the escalated fiscal year 2004 level as I did not remove the portion of the Company's adjustment associated with the support of new systems and information technology security requirements.

Q. WHY DO YOU RECOMMEND THAT THE COMPANY'S $783,000 ADJUSTMENT FOR THE REDUCTION IN INFORMATION TECHNOLOGY VENDOR REBATES BE REMOVED?

A. According to the information provided, PacifiCorp has contracts with six information technology vendors that give the Company volume rebates of 1% to 6% based on PacifiCorp's total use of these vendors. The response to CCS data request 3.33 indicates that PacifiCorp's fiscal year 2006 budget includes more routine information technology support being provided by employees rather than contractors and less on information technology capital projects, resulting in the Company's expectation that it will not achieve the volume necessary to receive the same rebate amounts during the future test year. The problem with PacifiCorp's adjustment is that the non-labor expenses included in the accounts being adjusted, specifically FERC accounts 923 and 930, are based on fiscal year 2004 expense levels with escalation factors being applied. Consequently, the future test year does not reflect the impact of the Company's projected reduction in the use of these information technology vendors providing the rebates. The Company is including the full historic test year cost for these information technology vendors, plus escalation on these costs, and a further increase in the costs to reflect a removal of the rebates received. Clearly it is not appropriate to remove the impact of the rebates without also reflecting the reduction in the vendor costs that the Company is projecting will decline. Therefore, I reversed the impact of the Company's removal of the rebates on CCS Exhibit 1.24.

Q. ON WHAT BASIS ARE YOU REMOVING PACIFICORP'S ADJUSTMENT FOR CIO CONTINGENCY FUNDS?

A. The response to CCS data request 3.33 describes the purpose of the $1.5 million adjustment for CIO Contingency Funds as follows:

> CIO Contingency Funds are those funds budgeted for IT Initiatives that are funded across multiple business units. A business decision was made that it would be more effective to have a central budget than a budget distributed among several business units so for FY 05 and FY06 the budget was centralized in IT. The FY 06 fund budget is $1.5M. Examples of projects funded by this budget include but are not limited to FDQ-FERC Data Quality, SAP Business Warehouse Blueprint and KWK2 – Commercial Risk System Upgrade.

The problem with the adjustment is that the amounts spent on these types of projects prior to the central budget being implemented remain in the future test year at an escalated amount. There was no adjustment reflected in the filing to reduce the balance recorded in the books in the FY 04 historic period prior to application of the escalation factors. Thus, the Company's addition of $1.5 million to reflect the fact that these funds are now centralized results in a double counting of these costs.

<u>Income Tax Issues</u>

Q. DO YOUR EXHIBITS INCLUDE AN ADJUSTMENT TO SYNCHRONIZE THE INTEREST EXPENSE DEDUCTION IN THE INCOME TAX CALCULATION WITH THE COMMITTEE'S RECOMMENDED RATE BASE?

A. Yes. The impact of the application of the weighted cost of debt on the Committee's recommended rate base in determining the interest deduction used in determining income tax expense is included in the summary schedules in Exhibits 1.1 and 1.2 for the Rolled-In and Revised Protocol methods, respectively. This is consistent with past practice and often called the "interest synchronization adjustment."

Q. COMMITTEE WITNESS MICHAEL ARNDT HAS RECOMMENDED AN ADJUSTMENT TO INCOME TAX EXPENSE. ARE THERE ANY ADDITIONAL INCOME TAX ISSUES THAT NEED TO BE RAISED IN THIS CASE?

A. Yes. There are two additional issues that need to be addressed. President Bush recently signed the American Jobs Creation Act of 2004 into law. Included in the Act is a deduction for income attributable to United States production activities. For taxable years beginning in 2005 and 2006, the deduction is 3% of the qualified production activities income, increasing to 6% for taxable years beginning in 2007, 2008 and 2009. It is likely that a portion of PacifiCorp's regulated income will be derived from a qualified production activity and the Company will receive the 3% deduction for federal income tax purposes.

CCS data requests 24.13 asked the Company to provide the projected impact on the fiscal year 2006 amounts included in the filing for income taxes, deferred income taxes and accumulated deferred income taxes as a result of the recent passing of the American Jobs Creation Act of 2004. The Company responded that it is "…still studying the language of this new law. There are several new terms which will be subject to interpretation and guidance from the IRS in determining the 'qualified production activities income' that the 3 percent tax deduction is computed on." The Company gave no further information. In response to CCS data request 24.12, the Company stated that it has not yet conducted "…any projections, studies or analysis regarding the impact of the American Jobs Creation Act of 2004."

The American Jobs Creation Act of 2004 is a known change that will provide benefits that should be reflected in the test year. I recommend the Commission require the Company to provide its best estimate of the impact of the new Act in its rebuttal testimony. The Commission should also require the Company to provide all workpapers and assumptions used by its internal tax department (and external tax consultants) in determining the estimated impact.

Q. WHAT IS THE SECOND TAX ISSUE THAT NEEDS TO BE ADDRESSED?

A. The Job Creation and Workers Assistance Act of 2002 and the Jobs and Growth Tax Relief Reconciliation Act of 2003 allow for considerable bonus deprecation for income tax purposes. Most utility plant additions qualify for the bonus depreciation. Under the 2003 Act, bonus depreciation of 50% is allowed for plant placed into service before January 1, 2005 or, in the case of certain property having a longer production period, before January 1, 2006. The bonus depreciation results in an impact on the accumulated deferred income tax offset to rate base as the depreciation deduction for income tax purposes in the years the bonus depreciation is in effect is considerably higher than the recorded depreciation expense on the Company's books.

DPU data request 3.9 asked the Company whether the impact of these Acts pertaining to bonus depreciation were included in the forecast of plant additions. The Company's response indicated that the 2002 and 2003 Acts were included in the forecast of plant additions through December 31, 2004. The responses also stated that "…some assets, placed in service after December 31, 2004 and before January 1, 2006, could qualify for bonus depreciation for the amount of the costs incurred through December 31, 2004. Those qualifying assets placed in service in calendar year 2005 have not been isolated and have not been included in the forecast of bonus depreciation on plant additions."

Subsequently, in CCS data request 24.14, the Company was asked to "…conduct an analysis of the plant additions included in the filing that are projected to be placed into service during 2005 to determine which may qualify for bonus deprecation on the amount of costs projected to be incurred through December 3, 2004." The data request also asked the Company to provide the projected impact on the offset to rate base for accumulated deferred income taxes resulting from the analysis. The response to CCS 24.14 was due on November 4, 2004. As of November 29, 2004, a response still had not been received. I was informed that the Company was working on a response. Once the response is filed, the impact on the 2006 test year accumulated deferred income tax offset to rate base should be reflected.

Q. DO YOU HAVE ANY ADDITIONAL CONCERNS WITH THE COMPANY'S INCOME TAX EXPENSE CALCULATIONS?

A. Yes. Schedule M additions increase taxable income, thereby increasing income tax expense. There are two items contained with the Company's Schedule M adjustments that warrant additional discussion. Included in the Company's temporary Schedule M additions (which increase taxable income in the tax calculation) is "avoided costs". The Company's filing shows this “avoided costs” Schedule M addition increasing from $7,351,667 as of the twelve months ended September 2003 to $34,425,249 in the future test year. As shown on CCS Exhibit 1.25, inclusion of the $34,425,249 as a Schedule M addition results in increasing combined state and federal income tax expense by $5,601,175 and increasing revenue requirement by $9,099,669.

Q. ARE YOU RECOMMENDING THE IMPACT OF THE “AVOIDED COST” SCHEDULE M ADDITION BE REMOVED FROM THE COMPANY’S FILING?

A. No, not at this time. There is no description in either the Company’s testimonies or its exhibits discussing this Schedule M addition. At this point, I do not know what is driving the projected significant increase in the Avoided Costs Schedule M addition. I recommend that the Company address this issue in its rebuttal testimony, describing for the Commission what the Avoided Cost Schedule M Addition is for and why it is projected to increase by such a large amount in the 2006 test year. If an adequate description and justification is not provided, then I recommend the Commission reflect the adjustment presented on CCS Exhibit 1.25.

Q. WHAT IS THE SECOND ITEM CONTAINED IN THE COMPANY'S SCHEDULE M ADJUSTMENTS IN ITS INCOME TAX EXPENSE CALCULATIONS YOU WISH TO ADDRESS?

A. Included in the Schedule M additions in the income tax calculations is $5,479,353 for acquisition adjustment amortization. In the current case, the Company's filing includes the following items pertaining to the electric plant acquisition adjustment: (1) net electric plant acquisition adjustment in rate base of $87,732,518 ($35,267,421 Utah); (2) plant acquisition adjustment amortization expense of $5,479,353 ($2,296,293 Utah); and (3) Schedule M Addition of $5,479,353 ($2,296,293 Utah). Inclusion of the Schedule M addition essentially results in the amortization expense not flowing through the income tax expense calculation. While the positive acquisition adjustment has been included in several prior PacifiCorp rate cases, to the best of my knowledge, the Commission has not specifically addressed the appropriateness of the inclusion of the positive acquisition adjustment in rate base.

To the best of my knowledge, the Company has not presented testimony in the current case or in any prior case before this Commission justifying the recovery of a positive acquisition adjustment from ratepayers. Positive acquisition adjustments result from companies paying above book value for the assets of another company. Ratepayers should not be expected to pay more than the net book value of the assets that are used to provide them service. Allowing the Company to earn a return of and on a positive acquisition adjustment results in ratepayers paying more than the net book value of the assets that are being used to serve them. This is not appropriate absent some compelling justification to the contrary.

Q. DO YOU RECOMMEND THAT THE ACQUISITION ADJUSTMENT BE REMOVED IN THIS CASE?

A. No, not at this time. The purchases resulting in the positive acquisition adjustment took place in the early 1990s. The Committee is still investigating whether or not the Commission has ever addressed the positive acquisition adjustment. To the best of my knowledge, it has not. However, I do recommend that the Company provide rebuttal testimony on this issue in order to justify the recovery from Utah ratepayers of the positive acquisition adjustment.

Q. DOES THIS COMPLETE YOUR PREFILED TESTIMONY?

A. Yes, it does.