BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION OF PACIFICORP FOR APPROVAL OF ITS PROPOSED ELECTRIC SERVICE SCHEDULES AND ELECTRIC SERVICE REGULATIONS	DOCKET NO. 04-035-042 DPU EXHIBIT BSM 4

Direct Testimony of

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Division of Public Utilities

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TESTIMONY OF BRUCE SCOTT MOIO

Docket No. 04-035-042

INTRODUCTION

Q: Please state your name, business address, employer, and title.

A: My name is Bruce Scott Moio; my business address is 160 East 300 South Salt Lake City, Utah 84114; I am employed by the Division of Public Utilities as a utility analyst.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of the Division of Public Utilities ("Division").

Q: Please summarize your educational and professional experience.

A: I earned a bachelors degree in accounting from Loyola Marymount University. I have 20 years of corporate accounting experience. While at the Division I have worked on a number or projects including public utility regulatory fee calculation and assessment, implementing the certification process for several water utility companies, and various other accounting projects involving regulated utility companies. I also successively completed the annual NARUC Regulatory Accounting Studies Program in 2004. I am also a member of the Association of Certified Fraud Examiners.

SCOPE AND SUMMARY OF TESTIMONY

Q: What is the purpose of your testimony in these proceedings?

A: I will present testimony on the following Division adjustments: Gadsby lease waiver, Cash in working capital, Capital additions, Fuel Stock, Regulatory Asset error, Trapper Mine Royalty agreement, Energy West Mining self insurance for Black Lung, and the Pension Reserve.

Q: Please explain the Gadsby Lease Waiver Adjustment.

A: When PacifiCorp applied for a certificate to build the Gadsby units in Docket No. 01-035-37, Company witnesses testified that the decision to build the combustion turbines at Gadsby was preferable over other available alternatives. J. Rand Thurgood testified for the Company that the Company's decision to install General Electric LM 6000 gas turbines was based in part upon: "…the economic benefit PacifiCorp and its customers would realize from General Electric's (GE) agreement to waive the additional fixed cost obligation to lease the temporary mobile gas turbines for another five months."[1] Mr. Thurgood further testified that: "GE's agreement to release the Company from its lease obligation associated with an additional five months rental for the mobile gas turbines has a net impact of reducing 2002 operating expenses by $7.5 million. Simplistically, this has the impact of reducing the effective capital cost equivalent for this particular project to approximately $608/kW."[2] When the Company compared the GE LM 6000 units with other alternative generating options for the Gadsby addition this amount was used. However the cost comparison[3] provided by Mr. Thurgood showed that the $/Mwh cost of four other options was close enough to the selected GE LM 6000 alternative that they may have been competitively preferable for Utah ratepayers absent rate consideration for the $7.5 million offset to the capitalized cost of the GE LM 6000 units for the lease expense waiver. Therefore, when the Company wanted the Commission to approve their application to build the Gadsby units, they relied in part on the argument that the decision to construct the GE LM 6000 gas turbines would benefit ***both*** the Company and the

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[1] J. Rand Thurgood testimony in Docket No. 01-035-37 @ page 5 line 15.

[2] Id. Page 12 line 3.

[3] Id. Confidential Exhibit JRT-3

ratepayers.

The estimated construction cost of the Gadsby units was reduced by $7.5 million for the lease obligation payment waiver when comparisons were made with other competitive alternatives. However, in response to the Division's data request, PacifiCorp indicated that the $7.5 million in cost savings was not treated as a reduction in the capital cost of Gadsby in their rate application, they were treated as a $7.5 million reduction in the 2002 O&M expenses.[4] The Utah ratepayers did not benefit from the GE lease payment waiver. PacifiCorp's rates at that time were determined in Docket No. 01-035-01. The expenses associated with the GE lease were outside of the test period and no adjustment was made to include them for rate-making. While the Company may argue that absent the waiver, PacifiCorp would have had $7.5 million more in net power costs in that case test period, other parties could have persuasively argued that such costs were one-time non-recurring costs which should be excluded from rate-making. Therefore, contrary to the Company's assertion that the lease payment waiver benefited both the Company and the Utah ratepayers, it appears that only PacifiCorp stockholders benefited from the arrangement based on the Company's filing.

In my opinion it would be equitable to reduce the rate base amount approved for the Gadsby units by the Utah allocated portion of the current value of the $7.5 million cost reduction, consistent with the way the Company recognized the amount in comparing alternatives in making the decision to purchase the GE LM 6000 units. In this way the

[4] Docket No. 03-2035-02 PacifiCorp response to DPU data request No. 19.1.

rate reduction will continue as long as the costs associated with Gadsby are recovered in rates from Utah ratepayers, and consequently Utah ratepayers will benefit from the lease waiver consistent with the Company's arguments when the Commission approved the certificate to build the units. As shown on DPU Exhibit 4.1 this adjustment reduces rate base by $2,806,970. Shown on DPU Exhibit 4.12 are the Utah allocated corresponding adjustments to depreciation expense of $104,770 and accumulated depreciation of $104,770. The total impact of the Gadsby adjustments on the Company's revenue requirement is approximately $441,000.

Q: Please explain the Cash in Working Capital adjustment.

A: Historically PacifiCorp has maintained a low, and sometimes negative cash balance. The average cash balance for the four year period from 2000 through 2003 has been $(225,000)[5] For the 2006 test year the Company has included $13.4 million in the cash balance. In my opinion it does not seem reasonable for the Utah ratepayers to pay PacifiCorp a return on cash the Company has not historically kept on its books. PacifiCorp has demonstrated the ability to function quite well with a small cash balance, even a negative cash balance, in the recent past. DPU Exhibit 4.2 shows that this adjustment reduces the rate base by a Utah allocated amount of $5,720,799. The impact of this adjustment on the Company's revenue requirement is approximately $706,000.

Q: Please explain the Capital Additions adjustment.

A: PacifiCorp has included in its 2006 test year many capital additions that it has projected

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[5] FERC Form No. 1 2000, 2001, 2002 and 2003.

and budgeted for. In order to arrive at capital addition amounts for 2006, the Company also had to forecast some projects for the year 2005. The Division was careful to look at these budgets and projections in order to prevent the rate recovery for budget/projections that are inflated or inefficient or including for revenue requirement computation those capital additions that would not yet be completed nor be serving the ratepayers within the projected in-service dates. The Division audited the Company's historical performance regarding it's completion of capital addition projects that were budgeted as well as the Company's overall efficiency in budgeting for capital projects. Clearly PacifiCorp has been aware of the variance disparity dilemma it has had in regards to the amount budgeted versus the actual amount spent for capital additions. An internal audit report dated January 16, 2003 showed a variance that the budgeted amount was 34% over the amount actually spent on capital additions during the first half of fiscal year 2003. This report also states that there were problems with closing projects on a timely basis and the utility spending money on projects that were eventually cancelled. The report cited over $100 million in projects which were inactive for over six months, as well as costs for projects that were not completed and were inappropriately capitalized and should have been expensed.[6]

The Quantum Leap program was instituted as a construction and infrastructure improvement program to improve reliability and service along the Wasatch Front in Utah. A PacifiCorp internal audit of the Quantum Leap program dated March 3, 2004 further identified inefficiencies regarding the accounting for capital additions.

[6] PacifiCorp Internal Audit Report P03/03 Capital Expenditures.

Although this internal audit report cited some improvements in the accounting for capital expenditures from the 2003 internal report, there were still many inefficiencies. The report stated: "At the time when the projects were presented to the Board of Directors for approval (the additional $157 million) the individual projects did not have detailed scopes, and the budgets requested were based on block estimates, in accordance with PacifiCorp's policy...Block estimates are by Distribution's definition +/- 30% accurate."[7] It is my understanding that block estimates are the initial estimate/budget for a project that is brought before the Board of Directors for approval to begin a project. As the project progresses, these budgets are then fine tuned. It should be noted, however, that these block estimates are the basis for the initial budgets on these projects. Furthermore, the 2004 internal audit report notes that a number of projects had been removed from the official project list but, when comparisons with actual expenditures were made, it was discovered that the associated dollars remained in the budget. Also the report noted there was a lack of review of project invoices that poses a risk for incorrect or even over-billing.

PacifiCorp's own internal audit reports clearly demonstrate a problem in correctly budgeting capital projects, completion of capital projects in a timely fashion, and a potential for over-billing which results in inflated capital costs. Based on my analysis, it is my opinion that projecting capital additions for 2005 and 2006 based on over-estimated or inflated budgets, compounded with the potential of over-billing likely means the capital additions amount is overstated in this rate case. In order to compare

[7] PacifiCorp Internal Audit Report P04/25 Quantum Leap Project.

some of these budgeted amounts with actual amounts spent currently, the Division analyzed recent budget vs. actual variance reports. In response to CCS Data Request 6.31 the Company provided a spreadsheet report comparing filed (budgeted) vs. actual amounts spent for major plant additions for the period April 1, 2004 through August 31, 2004. Initial observation of this report disclosed that the budgeted amount exceeded the actual amounts by 9%. However closer analysis of this report provides a much different variance. This report included over $2.5 million of actual dollars spent on projects with no corresponding budget amounts which inflates the actual total. The explanation column for these entries shows that most of these were the closing of previous year's expenditures. These amounts should not be included in this variance report comparing the budget amount versus an actual amount spent based on that budget. When these amounts are removed from this report the actual variance is 13%.

A further breakdown of this comparison, by including only projects over $100,000, puts the variance at 19%. When projects over $1 million are isolated the variance is 29%.[8] This analysis demonstrates the Company's difficulties in accurately budgeting for projects as they increase in size. When the Company is budgeting/projecting capital additions for 2005 and 2006 with amounts over $1.6 billion, these variances become vital in trying to provide an accurate rate base amount for a future test year. It should be further noted here that all projects over $3 million must be approved by PacifiCorp's Investment Committee. According to the supplemental response to CCS Data Request 6.32 there are $136 million in projected capital expenditures allocated to Utah that <u>do not</u>

[8] DPU Exhibit BSM 4.36.

appear to have approval from the PacifiCorp Investment Committee at this time.

Based on these analyses I recommend a capital additions reduction adjustment based on the 13% variance at this time. The Division has requested updated amounts beyond August 2004 in DPU Data Request No. 18, therefore this percentage could change based on the data response which has not been received at the time of this testimony. DPU Exhibit BSM 4.3 shows that 13% of the amounts the Company has projected for capital additions for the years 2005 & 2006 equates to a Utah allocated $98,988,941 reduction. Corresponding depreciation adjustments are shown on DPU Exhibit BSM 4.35. Together these adjustments reduce Utah allocated rate base by $99.8 million and reduce Company's revenue requirement of approximately $13.7 million reduction. This adjustment should not hinder PacifiCorp in moving ahead with their expansion needs in Utah, but rather require the Company to more efficiently budget, manage, and account for these capital additions.

Q: Please explain the Fuel Stock adjustment.

A: PacifiCorp used $58.4 million for fuel stocks inventory in rate base in this rate case filing. When the previous 13 months are analyzed there is an obvious steady decline in fuel stocks, as shown on DPU Exhibit BSM 4.4. This was caused by the reductions in fuel stockpiles at the Hunter plant. Based on the historical reduction in fuel stockpiles shown in DPU Exhibit BSM 4.4, I believe it is unrealistic for PacifiCorp to project fuel stock inventories at the level in their application. This adjustment recommends reducing fuel stocks to the March 2004 level of $50.7 million. This adjustment reduces the Utah allocated rate base by $3,165,149 and has an impact on PacifiCorp's revenue requirement of approximately $390,000.

Q: Please explain the Regulatory Asset Amortization adjustment.

A: This adjustment corrects an error in PacifiCorp's rate filing. In JTW-2 page 4.13 the amount of $805,361 was not carried over to the Utah allocated column. DPU Exhibit BSM 4.5 shows the reduction in amortization expense account 930 for $805,361, this has an impact of reducing PacifiCorp's revenue requirement of approximately $849,000.

Q: Please explain the Trapper Mine adjustment.

A: PacifiCorp negotiated with GE to settle their Trapper Mine royalty agreement. The Company set up a one-time reserve account for the deferred GE royalty amount of $14,636,841 that will be paid out over a few years. In my opinion this is not an investment in plant and should not be included in rate base for the test year. This is a one-time non-recurring event that need not earn a rate of return by including it in rate base. Shown on DPU Exhibit BSM 4.6 this adjustment reduces rate base account 399 for the Utah allocated amount of $1,049,197. The impact on PacifiCorp's revenue requirement is an approximate reduction of $129,000.

Q: Please explain the Energy West Mining self insurance for Black Lung adjustment.

A: PacifiCorp has instituted a self-insurance program for Black Lung at Energy West Mining. The Company was finding it more and more difficult to locate an insurer that would insure for Black Lung at an affordable rate. PacifiCorp found it more prudent to set aside funds and self insure for this risk. PacifiCorp has set aside funds to cover potential claims for black lung. The Company was also expensing $320,000 per year in premiums. This adjustment removes this premium expense for the years 2005 and 2006. On DPU Exhibit BSM 4.7 the adjustment is a reduction to fuel expense account 501 for a Utah allocated amount of $263,468. This has a reduction impact on PacifiCorp's revenue requirement of approximately $272,000.

Q: Please explain the Pension Reserve adjustment.

A: The forecast for the accumulated provision for pensions used by PacifiCorp in the test year was $67.1 million. The 13-month average, shown on DPU Exhibit BSM 4.8, was $74.7 million. This adjustment simply replaces the PacifiCorp's forecasted amount of provision for pensions with the 13-month average. The result is a Utah allocated amount adjusted from rate base account 228.3 of $3,138,417, the impact on the Company's revenue requirement is an approximate reduction of $387,000.

Q: Does this conclude your testimony?

A: Yes.