Docket No. 04-035-42
David T. Thomson
Exhibit No. DPU 6.0
December 3, 2004

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. 04-035-42 Revenue Requirement Filing

DIRECT TESTIMONY

OF

DAVID T. THOMSON
STATE OF UTAH
DIVISION OF PUBLIC UTILITIES

DECEMBER 3, 2004

Q. Please state your name and business address for the record.

A. David T. Thomson. My business address is Heber M. Wells Building 4th Floor, 160 East 300 South, Salt Lake City, Utah 84114-6751.

Q. For which party will you be offering testimony in this case?

A. I will be offering testimony on behalf of the Utah Division of Public Utilities (Division).

Q. Please describe your position and duties with the Division of Public Utilities?

A. I am a Utility Analyst II. Among other things, I serve as an in-house consultant on issues concerning the terms, conditions and prices of utility service; industry and utility trends and issues; and regulatory form, compliance and practice relating to public utilities. I examine public utility financial data for determination of rates; review applications for rate increases; conduct research, examine, analyze, organize, document and establish regulatory positions on a variety of regulatory matters; review operations reports and ensure compliance with laws and regulations, etc.; testify in hearings before the Public Service Commission; assist in analysis of testimony and case preparation; and participate in settlement conferences, etc.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain certain adjustments that I am proposing to be made to the revenue requirement filing (filing) of PacifiCorp submitted to the Utah Public Service Commission on August 4, 2004 under Docket number 04-035-42.

Q. Have you conducted an investigation in regards to the adjustments that you are proposing?

A. I have.

Q. Please describe your investigation.

A. I have reviewed the information contained in the filing regarding operation and maintenance expenses; depreciation and amortization, taxes other than income taxes, Federal and State income taxes; administrative and general expenses; pension costs, employee benefits and accruals; bad debts; and deferred taxes and schedule M adjustments. The information reviewed consisted of reading the direct testimony of management and others of the Company and the many exhibits associated with that testimony; personal and telephone conferences with PacifiCorp personnel in Salt Lake City and Portland. I also reviewed pertinent information provide by PacifiCorp in data requests prepared for the Division and other Interveners who were also reviewing the filing.

Q. What conclusions have you reached after conducting your investigation and review of the above information?

A. I have concluded that certain operating expenses and rate base amounts, which I specifically examined during my investigation and review of the filing, should be adjusted.

Q. What is your First adjustment?

A. My first adjustment is to estimate the impact on the future test year for 2006 of the new tax law that came into effect during 2004.

Q. Please explain this adjustment.

A. Under the American Jobs Creation Act of 2004, electric utilities are now eligible for a deduction relating to income attributable to domestic production activities.

For the year 2006, PacifiCorp will be allowed a deduction of an amount equal to 3% of the lesser of A) the qualified production activities income of PacifiCorp, or (B) its taxable income. The law was just passed and much is still not known on how to implement the provisions of the law pertaining to production income. However, it is apparent under the law that the deduction does not specifically apply to revenue from transmission and distribution functions.

After reading the law and other articles written about the deduction it is my feeling that the deduction for PacifiCorp will probably be based on qualified production activities income that will be lower than the Company's taxable income. Taxing jurisdictions have allocated revenue based on fixed asset cost or expense between states or types of activities. Using this methodology, for my estimate, I have tried to determine what the production income for the Company would be by dividing total purchase power expense plus transmission and distribution expense by the plant production and supply expense (including purchase power expense) plus transmission and distribution expense. These numbers were taken from exhibit JTW-1. This could give a rough estimate of what expenses are attributable to production and what is not (See Exhibit 6.1(a)). This method assumes that such expenses are directly related to revenue in a like percentage. The percentage attributable to production under this methodology is 46%. Using the final allocated number in the future test year for Utah taxable income, the production income deduction for Utah would be estimated at

$1,623,986 (taxable income page 2.21 of JTW-1 x .46 x .03). This would be deducted from taxable income and then multiplied by .35 or you could multiply the $1,623,986 by .35 to get the Utah tax savings. I have computed the tax savings to be $568,395.

I would be interested to see what the Company's estimate is going to be for this deduction for the 2006 future test year. This deduction under the new legislation will definitely apply to the future test year and the best estimate of what the deduction will be should be included in the final rate filing.

Q. What is your Second adjustment?

A. My second adjustment is to remove the implementation costs associated with complying with the provisions of Sarbanes-Oxley.

Q. Please explain this adjustment.

A. The costs associated with implementing the provisions of Sarbanes-Oxley are non-recurring costs and should not be included in the 2006 future test year operating expenses. As provided in data request DPU 4.23 to the Division by PacifiCorp, the total amount for implementation of Sarbanes-Oxley for the year ended 2004 was $2,158,969. It is assumed that these costs were included in administrative and general expense and were escalated to future test year expense using 2005 and 2006 DRI indexes, as was done for all other O & M non-labor expense in the filing. Thus the future test year expenses included a calculated amount of $2,319,445 for Sarbanes-Oxley related implementation costs (See exhibit 6.2(a)). Applying the SO allocation factor percentage of 41.6087% to this amount results in a Utah allocated expense adjustment reduction of $965,091.

Q. What is your Third adjustment?

A. My third adjustment is to reduce bad debt expense to reflect PacifiCorp's new bad debt methodology.

Q. Please explain this adjustment.

A. At the end of fiscal year 2004 PacifiCorp adopted a new mythology for determining its allowance for bad debt. An adjustment to reflect the results of this new methodology was made to the books, which reduced the allowance, by $5,800,000. This adjustment was made prior to or at year-end to correct this overstatement. After the adjustment Utah's expense for bad debt was $1,732,190 at fiscal year end 2004.

The Company made adjustments to normalize this expense. That adjustment increased the bad debt expense specifically for Utah to $3,760,310 and that is the amount in the filing (Exhibit JTW-1 the O & M summary page 4.1.10 line 904UT). However, this adjustment puts the expense back to levels that were used under the old expense calculation methodology (See exhibit 6.3(a)).

In section 4.1.1 entitled "Analysis Results" in PacifiCorp's Internal Audit Report PO4/22 entitled "Bad Debt Reserve"; the internal auditors determined that "the bad debt general reserve component percentage is trending at approximately 5% of the A/R balance." It also states that "… the reduction in the reserve is approximately 2% ………" meaning the reserve needed to be reduced by 2% to come to a more proper balance. Adjusting the bad debt expense to old balances that existed prior to the implementation of the new methodology would ignore the need to reduce the expense to levels that would reflect the reduction of the allowance to proper levels. It appears that this is exactly what happened in the filing. (See Exhibit 6.3(a)). Thus, I propose that the amount in the filing be reduced to a level that more properly reflects the bad debt expense under the new methodology. That adjustment computes to be a $1,033,318 reduction.

A more accurate way to compute the expense would be to take the Utah accounts receivable at March 2006 and multiply that amount by the proper percentage under the new methodology to see what the allowance should be and then do the same methodology for the previous 12 months to arrive at an average bad debt expense and use this in the filing. However, since we are using a future test year it is impossible to have the 2006 accounts receivable amounts since that data does not exist. The FERC definition for this account (bad debt) is that it is the offset to account 144, Accumulated Provision for Uncollectible Accounts, which is related to losses from uncollectible utility revenues. Since we do not have knowledge as to accounts receivable balances, I used an historical based methodology to estimate the bad debt expense for 2006.

Q. What is your Fourth adjustment?

A. My fourth adjustment reduces contract services in account 593 for costs associated with the major winter storm outage in December of 2003.

Q. Please explain this adjustment.

A. An analysis of maintenance and overhead lines expense in account number 593 shows abnormally large contract charges for the months January through March 2004. The charges are in sub accounts 530152 and 530180, which are entitled contract line construction maintenance, and Miscellaneous contract & services.

The average or normal costs in these accounts from April '03 to December '03 are $302,471 and $418,039 respectively. Total costs in these accounts from Jan 2004 to March 2004 were $4,270,095 and $3,179,247 (See exhibit 6.4(a)) and the excess above the monthly average for the three months was $3,362,681 and $1,925,129 respectively. PacifiCorp has filed with the Public Service Commission claiming the December 2003 storm was an abnormal event. Therefore, the extra expenses associated with the storm should be removed in projecting the future test year expenses. This adjustment reduces the charges in accounts 530152 and 530180 to normal levels. This reduction in expense is prorated between the Utah jurisdiction and others based on the actual loss incurred in each jurisdiction. It results in a reduction of $2,960,645 to the Utah jurisdiction in the fiscal year end 2006 filing.

Q. What is your Fifth adjustment?

A. My fifth adjustment is to reduce the filing's future pension cost to levels that better reflect estimated 2006 future costs.

Q. Please explain this adjustment.

A. Based on updated amounts as provided in data requests, I believe PacifiCorp's estimate of pension trust fund amounts at 2006 are understated and that its number of employees at 2006 who will be covered by the plan to be overstated. These facts have caused the future pension cost to be overstated in the 2006 filing.

In response to UIEC Data Request 2.6, the Company projected its pension trust fund balances to be $726 million at January 1, 2005 and $752 million at January 1, 2006. Also, in response to UIEC Data Request 1.28, the Company responded that the value of the assets held in the PacifiCorp Master Trust as of December 31, 2003 was $737,961,000. This amount at December 31, 2003 is only $15 million less than the estimated pension trust fund balance for the January 1, 2006 amount used in the rate filing. Based on the fact that the stock market has done well during 2004, it could be possible that the value now is over the 2006 projected amount. I believe that this is a strong indication that the balance amount in the projection is too conservative and consequently the pension expense in the filing is overstated.

In UIEC Data Request 2.6, the Company responded that for fiscal year '06 projections, it is assumed that there will be 4,800 employees covered by the plan. At fiscal year 04, there were 4,325 employees covered by plan. This indicates a 10.98 % increase in employee count over the next two years. However, based on the testimony of Bart Croxford of the DPU (DPU Exhibit 5.0), the lowering of overall growth in employees as explained by him would correlate into a significantly lower number of employees covered by the plan in 2006.

Using the actual growth rate of $27 million for 2003 (1-1-03 minus 1-1-04 or $738 million minus $711 million) and applying the same annual growth amount to 1-1-05 and 1-1-06 computes to a trust fund balance of $792 million. Thus with all other things held constant, what would be the pension expense reduction if the 1-1-06 pension trust fund balance was $792 million instead of $752 million at '06 and the assumed number of employees was 4,572 instead of 4,800 at '06? An exact amount is difficult to determine but the amount would be less than the pension expense amount in the filing.

In its 2006 pension expense projection the company assumes that expected long-term return on plan assets to be 8.75%. It states in UIEC Data Request 2.7 that if the assumption was 9.75%, and all other assumptions remained constant, that the projected pension expense would decrease by $8.1 million. Based on my discussion of asset growth above and the fact that the employee number assumption is overstated, I believe if all other assumptions used to compute pension expense remained constant and the two assumptions I discussed were adjusted (asset growth to a higher amount and employees covered by the plan to a lower number), that the projected pension expense would be overstated. The overstated amount would at least be $8.1 million. Again, the Company in response to UIEC Data Request 2.7 determined that a 1% increase in growth rate would reduce pension expense $8.1 million. I used the $8.1 million amount for the basis of my adjustment.

Q. What is your Sixth adjustment?

A. My sixth adjustment is related to the rate base adjustment to future additions in the filing as outlined in Bruce Moio's Division testimony (DPU Exhibit 4.3). Property tax expense should be adjusted so that it reflects a proper amount after rate base is adjusted.

Q. Please explain this adjustment.

A. Property tax for the filing reflects the tax expense before the reduction of rate base additions by Mr. Moio. The property tax expense before reduction is $75,006,000. A reduction to this amount is required for the decrease in rate base that is subject to property tax. The reduction was simply computed by dividing estimated total rate base from PacifiCorp's JTW-1 exhibit into the total reduced number (per DPU Exhibit 4.3) to arrive at a percentage decrease due to the asset reduction adjustment. The number computed is approximately 3.6% (See Exhibit 6.6(a)). Taking the 3.6% and multiplying it by the total tax amount ($75,006,000 x .036) generates a total company reduction of $2,727,794. Using the GPS Utah allocation factor of 41.6087% results in a Utah adjustment of $1,135,000.

Q. Does this conclude your Testimony?

A. Yes.