Q. Are you the same Daniel J. Rosborough who previously testified in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to rebut the testimony related to the Company's requested retirement plan (pension) expense filed by Committee witnesses Donna Deronne and Helmuth Schultz, UAE witness Richard Anderson, Division witness, Dave Thomson and UIEC witness Michael Gorman. In addition, I rebut the testimony filed by Mr. Schultz related to other benefits offered by the Company.

<u>Pension Expense</u>

Q. Several of the intervening witnesses raise issues regarding the proposed recovery of FY06 pension expense as being too speculative. Please clarify the basis for the Company's proposed recovery of pension expense.

A. The Fiscal Year (FY)05 expense was used as the starting point for the test period (FY06) projected expense. Contrary to the implication raised in the intervenors' testimony, FY05 pension expense is an actual expense currently being incurred by the Company. It is fully supported by the FY05 (measurement date January 1, 2004) valuation report prepared by Hewitt Associates, which is provided as Exhibit UP&L___ (DJR-1R).

Q. Several intervenors questioned the inclusion of increased participant counts in the pension expense calculations (Mr. Gorman, Mr. Thomson). Can you clarify the numbers of employee participants used in calculating the FY06 expense for the PacifiCorp Plan?

A. Yes. Mr. Thomson and Mr. Gorman both express concern that the number of participants in the plan for FY06 is overstated based at least in part on their conclusion that the number of participants is about 11 percent higher than in FY04. In addition, Mr. Thomson asserts that the number of FY06 participants may be impacted by the lowering of overall growth in employees from projected numbers as discussed in Mr. Croxford's testimony. These arguments reveal a fundamental misunderstanding of plan eligibility, ignore actual FY05 participation levels and should be rejected.

Q. Please explain how actual FY05 participation levels and plan eligibility requirements impact the projected expense.

A. For the FY05 expense calculation, the actuary uses the Plan demographics as of January 1, 2004. As of January 1, 2004, there were 4,521 active participants in the PacifiCorp Retirement Plan. To be an active participant, an eligible employee must be at least age 21 and complete one year of service with PacifiCorp. Thus, while Mr. Gorman characterizes these FY05 employee participants as "projected", in fact, all 4,521 active participants were hired in 2002 or earlier. Likewise, because the number of 2003 hires is already known (this group will be eligible for the Plan and recognized first in the FY06 expense), they are reflected when projecting the population to January 1, 2005 to estimate the FY06 pension expense. Employees hired in 2004 will not be included until the January 1, 2006 measurement date and thus will not be reflected in pension expense until fiscal year 2007. Likewise, the post December 31, 2003 employee increases discussed in the testimony of Mr. Croxford would not be included in any of the expense calculations provided in this filing. Thus, the test year projections reflect 4,800 active participants (4,521 plus 279 net new participants) as of January 1, 2005. In any event, while intervenors have expressed concern that the number of employees included within the Company's projected FY06 expense is overstated, it is important to note that new participants have a minimal impact on the pension expense because of their limited past service liabilities and the likelihood that many of them will terminate prior to becoming vested (at five years of service).

Q. Several Intervenors recommended using FY04 pension expense for the PacifiCorp Plan because the FY05 and subsequent calculations of expense and the Plan's FY05 valuation report were not available. Is this appropriate?

A. No. As indicated in my original testimony, the actual FY05 PacifiCorp Plan expense was $31.5M as documented by the valuation report. Although the expense calculation was completed in June, 2004, the availability of the valuation report, copies of which have been provided to the parties, was delayed because the actuary was waiting for the external auditor to complete its audit. The $31.5 M expense I reported in my direct testimony did not change in the final valuation report.

Q. How do you respond to intervenors' criticism that without a full actuarial report the FY06 pension projection is speculative in nature and therefore, the Commission should adjust the company's pension expense to FY04 levels?

A. I disagree. The FY05 expense, which is the starting point for the test period expense, is an actual, reported expense which has been calculated by our actuary. That FY05 expense is, at $31.5 million, more than $17 million higher than FY04 expense. While projections of any type may not be an exact science, one thing is certain, the pension expense will not be at the historical level of FY04 and intervenor arguments to set the future test year pension expense at that level in spite of the evidence of significant increase in the expense for FY05 should be rejected. Moreover, as discussed in more detail below, we have a high level of confidence in the main variables and assumptions that will be used in calculating the FY06 expense. The Company's actuary provided an updated reconciliation of projected FY06 pension to actual FY05 pension expense, which is attached as Exhibit UP&L___ (DJR-2R). While the intervening time period between filing the case and the filing of rebuttal has provided additional clarification regarding these variables, importantly, the new information would increase, rather than decrease, the FY06 expense. In addition, in spite of the intervenors' attempts at painting FY06 pension expense as a complete unknown, pension expense is not made up of one year of data. Because the asset smoothing methodology provides for gains and losses to be phased in over a five-year period and equity returns seen in the mid-to-late 1990s are not anticipated in the near term, the pension expense is expected to increase over the next two to three years as recent investment losses continue to be recognized. Consequently, under the smoothing method used to calculate expense, only a portion of the past few years of investment losses were recognized in the 2004 expense calculation, keeping it relatively low. Therefore, while exact FY06 discount rates and returns will not be known precisely for some time, the previous four years of data do impact the overall pension expense level and are, given their historical nature, very much known.

Q. You mentioned that updated information would in fact increase the projected FY06 pension expense. Please explain.

A. When we filed this case, we expected the discount rate at year end 2004 to be 6.5 percent. Our actuary has informed us that they believe that it will be 6 percent, or lower. That discount rate reflects, as required by FAS 87, the current yields on high grade corporate bonds, and is subject to review and agreement by the Plan's actuary and the external auditor. That reduction in the discount rate will increase the FY06 pension expense above the $41.6 million included in the filing.

At the time of the original filing, we also assumed that investment return for 2004 would be below the assumed long term return on assets. Investment markets have recovered since that time and we now expect the 2004 return to be approximately 10.5 percent. However, this actual return will have a very minor impact on the expense projection for FY06 (at least relative to the impact of the significant accumulated losses still to be recognized) because asset gains (and losses) relative to the assumed return are smoothed over the subsequent five year period. The net impact of the investment return and discount rate changes will increase the FY06 pension expense from $41.6M to $47.2M

Q. Is the company seeking to recover the increased level of projected FY06 pension expense?

A. No. I point out this updated calculation to demonstrate that in spite of intervenor criticism of the variables that go into projecting pension expense, updated information in fact demonstrates that the Company's request is conservative. In addition, this updated information also makes clear that returning to FY04 pension expense levels is unwarranted and would result in substantial under recovery of test period expense. In fact FY04 pension expense levels would not even allow the Company to recover FY05 levels of pension expense.

Q. Mr. Gorman challenges the use of lower discount rates for FY05 and FY06 relative to FY04, and cites another PacifiCorp witness as providing contradictory evidence. What is the company's basis for projecting the FY06 discount rate?

A. As Mr. Gorman notes, the actuary must use a prevailing market rate of interest to discount liabilities. However, under FAS 87, that prevailing market rate must reflect the yields for high grade corporate bonds. Corporate bonds are defined for this purpose by the SEC and the Company's external auditors as those that are rated Aa or better, using Moody's Investors Service. Based on those facts, in the current interest rate environment, a discount rate higher than 6.25 percent would not be approved by our external auditor.

Q. Mr. Gorman states in his testimony that there is no basis for the Company's FY06 pension expense to be materially higher than FY04 expense. How do you respond?

A. The FY06 expense will be substantially higher compared to FY04 for the following reasons. First, the discount rate used in FY04 was 6.75 percent, but 6.5 percent was used for the original FY06 projection (again, we now expect the actual to be 6 percent or lower for the actual FY06 calculation). Second, through FY04, only $163M of a total accumulation of $450M of losses incurred from 2000 through 2002 (actual asset losses versus assumed asset gains) had been recognized, leaving $287M to be recognized, of which $176M must be recognized in the FY05 and FY06 calculations under the asset smoothing method allowed under FAS 87 and discussed above. The FY05 and FY06 calculations also reflect $19M (40% of a total gain of $48M; the remainder to be recognized between FY07-09) of favorable asset experience from 2003, leaving then a net loss of $157M to be recognized during those two years so, pension expense will continue to increase through at least FY07, at which time most of the accumulated losses will have been fully recognized.

Q. Mr. Gorman also states that the asset gains in 2003 should be reflected in the FY05 valuation report and would reduce expense. Were the gains reflected in the report?

A. Yes, as stated above, investment return in excess of the assumed return was reflected in the FY05 expense. Those gains do in fact help against the under-funded status of the plan, but that is just one of a number of factors that impact the overall funded status. The other primary drivers for funding levels are benefit accruals for the current year, company contributions and benefit payments made during the year and the discount rate used to measure liabilities. The net effect of all of these factors was to actually increase the Plan's under-funded status from FY04 to FY05, having the effect of increasing expense.

Q. Given that a portion of each year's pension expense is based on historical data, is it surprising that the pension plan would continue to increase above FY04 levels?

A. No. In fact, in rate cases in Oregon and Wyoming last year based on FY03 information, I provided testimony that, based on the analysis provided to the Company by Hewitt Associates, the Company forecasted pension expense would be:

- 2005 - $27.3 million;
- 2006 - $42.1 million;

Therefore, despite intervenors' claims regarding the "speculative" nature of FY06 pension expense, projected expense and actual experience have been closely aligned.

Q. Mr. Thomson recommends an adjustment to the pension expense because he believes that the company has understated Plan assets, primarily because the projections used by the company show an increase of only $15M over the two year period ending December 31, 2005. How do you respond?

A. The Company believes it has not understated Plan assets. Mr. Thomson is projecting trust fund balances purely on the basis of additional investment returns. What he is not taking into consideration are the additional Company contributions during that period of $122M, which are offset by benefit payments made from the trust of $187M. Thus, the actual return, before factoring in contributions and benefit payments, is $80M over the two years, not $15M.

Q. In Ms. Deronne's testimony, she wonders whether asset gains in 2003 are reflected in the FY05 expense. Were they?

A. Yes, but remember that the amount of investment return in excess of 8.75 percent is smoothed over five years, so only 20 percent of that gain was recognized in FY05 (and 20% more recognized in FY06).

Q. Ms. Deronne also contends that there is no instruction or direction provided by the Company to the actuary in preparing the expense projections. Is that accurate?

A. No. The Company and the actuary collaborated on developing a set of reasonable short term assumptions to use for this purpose. These discussions are informal and typically done telephonically. Those assumptions are listed in exhibits previously provided in response to Discovery Request CCS 3.45 and in my direct testimony. Those assumptions are used, along with all other factors involved, by the actuary in the calculation of the projected expense. Those factors would include known amortizations of unrecognized amounts, as well as expected contributions and benefit payments.

Q. Ms. Deronne also argues that your investment return assumptions are unreasonable for both FY04 (4%) and FY05 (8%). Do you still feel these are reasonable?

A. We believe that the original 4 percent for 2004 was reasonable at the time the original projections were done, because the first few months of 2004 produced a 1 percent return. That has turned out to be conservative as the remainder of 2004 has produced better returns. We also still feel that the 8 percent in 2005 is reasonable as a short term projection of investment return, even though we continue to use 8.75 percent for a long term return on assets. We believe that over the short term, investment markets will under perform long term expectations. In doing these projections for this case, we tried to be as realistic as possible as to what we can expect from the investment and interest rate environments for the period of the projections. Even had we assumed for projection purposes the 8.75 percent asset return, the approximately $1M impact on FY06 expense would be more than offset by the $7M impact of using what we know to be a more reasonable discount rate of 6 percent or less.

<u>Other Benefit Expense</u>

Q. Mr. Schultz, has recommended a reduction in medical, dental and other benefit expenses based on his additional recommendation to reflect lower headcount in the rate case. Is this reasonable?

A. No, it is not. The projected expenses for the medical, dental and other benefit plans, including the 401(k) plan, did not incorporate any planned increases in headcount. Those expenses were based upon budgeted 2005 expenses and trended upward to reflect plan specific inflation (medical trend, salary increases, etc). There was no additional expense included for planned, but unhired, employees.

Q. Mr. Schultz also is recommending an adjustment to reflect the fact that PacifiCorp subsidizes a higher portion of medical costs than do other utilities. Does the Company disagree with this adjustment?

A. No. While Mr. Schultz has correctly cited one portion of the Hewitt Associates study, he fails to reflect the fact that the study also shows that PacifiCorp's plan is less generous than the plans of other employers. In addition, as stated in my original testimony, for the five years ending in 2003, PacifiCorp's overall per employee cost for medical expense was approximately 11 percent more favorable than national averages for the same types of plans. Since our plan value is not out of line with other employers and our actual cost experience is more favorable than average, Mr. Schultz's adjustment should be rejected. In addition, the Commission should recognize that the level of subsidy is a labor issue which requires bargaining between the Company and its labor unions. It is not an issue on which the Company can take unilateral action.

Q. Does this conclude your rebuttal testimony?

A. Yes.