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

Direct Testimony of

Maurice Brubaker

On behalf of

Utah Industrial Energy Consumers

(Contains Confidential Information)

Project 8279
December 3, 2004

BRUBAKER & ASSOCIATES, INC.

St. Louis, MO 63141-2000

659073.1

UIEC Exhibit 2 Redacted
Docket No. 04-035-42
Witness: M. Brubaker

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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**

<u>Direct Testimony of Maurice Brubaker</u>

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Maurice Brubaker. My business address is 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

Q WHAT IS YOUR OCCUPATION?

A I am a consultant in the field of public utility regulation and president of Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A I have been involved in the regulation of electric utilities, competitive issues and related matters over the last three decades. Additional information is provided in Appendix A, attached to this testimony.

CONFIDENTIAL

Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A I am appearing on behalf of the Utah Industrial Energy Consumers (UIEC). UIEC member companies purchase electricity from PacifiCorp.

Q WHAT IS THE SUBJECT OF YOUR TESTIMONY?

A My testimony addresses the determination of the provision for income taxes that should be included in PacifiCorp's revenue requirement.

Q WHAT IS THE RELATIONSHIP BETWEEN PACIFICORP AND SCOTTISH POWER?

A Scottish Power is a registered PUHCA holding company and PacifiCorp is an electrical utility operating company and a wholly owned subsidiary of Scottish Power.

Q PLEASE ELABORATE ON THE INCOME TAX ISSUE.

A When Scottish Power acquired PacifiCorp, it created a structure that allows it to minimize income taxes. In particular, there was a loan from XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXX pays interest on this loan and is able to deduct that interest expense for purposes of determining U.S. state and Federal income taxes. The interest deduction provides a significant tax shield to the income earned by Scottish Power from PacifiCorp's operations. In 2004, PacifiCorp Holdings Inc. became the parent of the consolidated group after the North American General Partnership (NAGP) was merged into it. This does not change the tax benefit.

Q DOES PACIFICORP TAKE INTO ACCOUNT THIS DEDUCTION WHEN CALCULATING INCOME TAXES TO INCLUDE IN ITS REVENUE REQUIREMENT?

A No, it does not. It calculates state and Federal income taxes for PacifiCorp without regard to the tax deductibility of this interest which shields the earnings at the PacifiCorp level from taxes.

Q WHAT IS THE MAGNITUDE OF THE TAX BENEFIT?

A Let me start by indicating that in PacifiCorp's last Utah rate case (Docket No. 03-2035-02), in response to UIEC Data Request No. 9.2, PacifiCorp revealed that the deductibility of $241.2 million of interest at a 35% Federal income tax rate produced a tax benefit of approximately $84.4 million. (State income taxes are also reduced.) The benefit flows from the financing structure as a result of the interest deduction reducing both Federal and state income tax obligations.

Recent Securities and Exchange Commission (SEC) documents[1] disclose that the current (as of December 31, 2003) loan balance was $2.375 billion, that the term of the loan was through 2017, that the interest rate was 6.75%, and that the amount of interest provided a tax benefit of approximately $61 million per year at a 38% income tax rate.

Q WHAT WAS THE PURPOSE OF THE REFERENCED SEC FILING?

A Scottish Power sought and received permission from the SEC to retain these income tax benefits in PacifiCorp Holdings Inc. rather than allocate them to other operations,

[1] See report of submission dated March 5, 2004 by Scottish Power to the SEC concerning its intercompany income tax treatment, and SEC Orders dated April 1, 2004 and May 28, 2004 concerning this matter. (See Release Nos. 27808, 27831 and 27851.)

including PacifiCorp. Although Scottish Power was doing this from the beginning it apparently was without SEC approval.

Q SHOULD THIS SEC ACTION AFFECT HOW RATES ARE SET BY THE PUBLIC SERVICE COMMISSION OF UTAH?

A No. Approval by the SEC of the treatment of the tax benefit should not compel the Public Service Commission of Utah to charge ratepayers for income taxes not paid.

Q SHOULD THE EXISTENCE OF THIS STRUCTURE AND THE DEDUCTIBILITY OF INTEREST BE CONSIDERED IN DETERMINING PACIFICORP'S RETAIL REVENUE REQUIREMENT?

A Yes, it should. Failure to take into account this financing structure and the reduced income taxes would effectively charge Utah customers for taxes that neither PacifiCorp, Scottish Power or any other entity is required to pay. PacifiCorp's proposed treatment ignores the existence of this benefit, and if adopted would charge Utah retail customers for taxes that no one is obligated to pay.

Q DO YOU KNOW THE AMOUNT OF THE BENEFIT FOR FISCAL YEARS 2004, 2005 OR 2006?

A No, I do not have that information. However, it has been requested in UIEC Data Request No. 13. Also, it is my understanding that the fiscal year 2004 income tax returns will be available for review on or about December 15, 2004.[2]

[2] In 2004, PacifiCorp Holdings Inc. became the parent of the consolidated group after NAGP was merged into it.

Q BASED ON THE MOST RECENT INFORMATION AVAILABLE, HOW MUCH IS THE BENEFIT AND HOW SHOULD THE PORTION ATTRIBUTABLE TO UTAH RETAIL OPERATIONS BE DETERMINED?

A As noted above, the estimated annual tax benefit based on the most currently available information is approximately $61 million at a 38% income tax rate.[3] Since this pertains to the acquisition of the entirety of PacifiCorp, the benefit must first be allocated between PacifiCorp regulated operations and other operations. Based on the summary of assets contained in the fiscal year 2003 Federal income tax filing by NAGP, regulated operations are entitled to the benefit of approximately 92% of this amount. The amount attributable to regulated operations must then be allocated to Utah jurisdictional customers. Based on the Company's claimed total company and Utah jurisdictional rate base for the 2006 test year, approximately 42%, or $23.6 million, should be allocated to Utah retail operations and the income taxes included in the revenue requirement should be reduced by that amount.

Q HAS THE COMMISSION PREVIOUSLY ADDRESSED THIS ISSUE?

A No. In fact, in the merger order the Commission specifically reserved this issue for consideration and determination in a future case.

Q IS THIS METHODOLOGY THE SAME AS LOOKING AT CONSOLIDATED INCOME TAXES AND TAKING ADVANTAGE OF LOSSES IN NON-REGULATED SUBSIDIARIES?

[3] This rate is essentially the same as the 37.95% composite effective tax rate in Utah.

A No, not at all. The approach I am suggesting merely recognizes the financing structure and the offset to taxable income created by the interest deduction. It does not reach to other operations to take advantage of income tax losses or credits that arise for other reasons.

Q IS THIS JUST A TIMING DIFFERENCE SIMILAR TO THE DIFFERENCE BETWEEN FLOW THROUGH AND NORMALIZATION ACCOUNTING FOR DEPRECIATION DEDUCTIONS?

A No. This is not the result of a timing difference, but rather is a permanent avoidance of income tax. It is a permanent tax reduction, and not a timing difference.

Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A Yes, it does.

Qualifications of Maurice Brubaker

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Maurice Brubaker. My business mailing address is P. O. Box 412000, 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

Q PLEASE STATE YOUR OCCUPATION.

A I am a consultant in the field of public utility regulation and President of the firm of Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A I was graduated from the University of Missouri in 1965, with a Bachelor's Degree in Electrical Engineering. Subsequent to graduation I was employed by the Utilities Section of the Engineering and Technology Division of Esso Research and Engineering Corporation of Morristown, New Jersey, a subsidiary of Standard Oil of New Jersey.

In the Fall of 1965, I enrolled in the Graduate School of Business at Washington University in St. Louis, Missouri. I was graduated in June of 1967 with the Degree of Master of Business Administration. My major field was finance.

From March of 1966 until March of 1970, I was employed by Emerson Electric Company in St. Louis. During this time I pursued the Degree of Master of Science in Engineering at Washington University, which I received in June, 1970.

In March of 1970, I joined the firm of Drazen Associates, Inc., of St. Louis, Missouri. Since that time I have been engaged in the preparation of numerous studies relating to electric, gas, and water utilities. These studies have included analyses of the cost to serve various types of customers, the design of rates for utility services, cost forecasts, cogeneration rates and determinations of rate base and operating income. I have also addressed utility resource planning principles and plans, reviewed capacity additions to determine whether or not they were used and useful, addressed demand-side management issues independently and as part of least cost planning, and have reviewed utility determinations of the need for capacity additions and/or purchased power to determine the consistency of such plans with least cost planning principles. I have also testified about the prudency of the actions undertaken by utilities to meet the needs of their customers in the wholesale power markets and have recommended disallowances of costs where such actions were deemed imprudent.

I have testified before the Federal Energy Regulatory Commission (FERC), various courts and legislatures, and the state regulatory commissions of Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Guam, Hawaii, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Missouri, Nevada, New Jersey, New Mexico, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, South Dakota, Texas, Utah, Virginia, West Virginia, Wisconsin and Wyoming.

The firm of Drazen-Brubaker & Associates, Inc. was incorporated in 1972 and assumed the utility rate and economic consulting activities of Drazen Associates, Inc., founded in 1937. In April, 1995 the firm of Brubaker & Associates, Inc. was formed. It includes most of the former DBA principals and staff. Our staff includes consultants with backgrounds in accounting, engineering, economics, mathematics, computer science and business.

During the past ten years, Brubaker & Associates, Inc. and its predecessor firm has participated in over 700 major utility rate and other cases and statewide generic investigations before utility regulatory commissions in 40 states, involving electric, gas, water, and steam rates and other issues. Cases in which the firm has been involved have included more than 80 of the 100 largest electric utilities and over 30 gas distribution companies and pipelines.

An increasing portion of the firm's activities is concentrated in the areas of competitive procurement. While the firm has always assisted its clients in negotiating contracts for utility services in the regulated environment, increasingly there are opportunities for certain customers to acquire power on a competitive basis from a supplier other than its traditional electric utility. The firm assists clients in identifying and evaluating purchased power options, conducts RFPs and negotiates with suppliers for the acquisition and delivery of supplies. We have prepared option studies and/or conducted RFPs for competitive acquisition of power supply for industrial and other end-use customers throughout the Unites States and in Canada, involving total needs in excess of 3,000 megawatts.

In addition to our main office in St. Louis, the firm has branch offices in Corpus Christi, Texas; Plano, Texas; Phoenix, Arizona; and Chicago, Illinois.

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