Witness CCS – 2
Exhibit CCS – 2

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

	)	**Docket No. 04-035-42**
In the Matter of the Application	)	
Of PacifiCorp for Approval of	)	**PRE-FILED DIRECT TESTIMONY OF**
Its Proposed Electric Rate	)	**HELMUTH W. SCHULTZ, III**
Schedules & Electric Service	)	**FOR THE COMMITTEE OF**
Regulations	)	**CONSUMER SERVICES**

December 6, 2004

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1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS**
3 **ADDRESS.**
4 A. My name is Helmuth W. Schultz, III. I am a Certified Public Accountant,
5 licensed in the State of Michigan, and a Senior Regulatory Analyst in the
6 firm of Larkin & Associates, PLLC, 15728 Farmington Road, Livonia,
7 Michigan 48154.
8 **Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES, PLLC.**
9 A. Larkin & Associates, PLLC is a Certified Public Accounting and Regulatory
10 Consulting firm that performs independent regulatory consulting primarily
11 for public service/utility commission staffs and consumer interest groups
12 (public counsels, public advocates, consumer counsels, attorneys general,
13 etc.). The firm has extensive experience in the utility regulatory field as
14 expert witnesses in over 400 regulatory proceedings involving electric,
15 gas, water and wastewater, and telephone utilities.
16 **Q. HAVE YOU PREPARED AN APPENDIX THAT DESCRIBES YOUR**
17 **QUALIFICATIONS AND EXPERIENCE?**
18 A. Yes. I have attached Appendix I, which is a summary of my experience
19 and qualifications.
20 **Q. BY WHOM WERE YOU RETAINED, AND WHAT IS THE PURPOSE OF**
21 **YOUR TESTIMONY?**
22 A. Larkin & Associates, PLLC, was retained by the Committee of Consumer
23 Services (CCS or Committee) to analyze the reasonableness of

1 PacifiCorp's (Company) request for a $111 million increase in its Utah
2 jurisdictional revenue requirement and to make recommendations to the
3 Utah Public Service Commission (Commission) in the areas of rate base
4 and operating income (expense and revenue).
5 Donna DeRonne, also of Larkin & Associates, PLLC, presents the
6 Committee's overall revenue requirement recommendation. I propose and
7 discuss several adjustments, including incentive compensation, base
8 payroll, payroll tax expense, employee benefits, directors and officers
9 liability insurance, working capital, and finally, the Western Area Power
10 Administration (WAPA) revenues for wheeling. The impacts of these
11 adjustments are reflected in the overall revenue requirement calculation
12 presented by Ms. DeRonne. Each of the adjustments I am sponsoring is
13 addressed below.
14
15 **INCENTIVE COMPENSATION**
16 **Q. YOUR FIRST ADJUSTMENT RELATES TO INCENTIVE**
17 **COMPENSATION. WHAT IS INCENTIVE COMPENSATION?**
18 A. Incentive compensation is compensation over and above the base wage
19 of an employee for job performance that exceeds expected performance
20 levels. Incentive compensation is typically called "at risk" compensation.
21 **Q. WHY IS IT NECESSARY TO MAKE AN ADJUSTMENT TO THE**
22 **COMPANY'S PROPOSED LEVEL OF INCENTIVE COMPENSATION?**
23 A. There are essentially five reasons for adjusting the Company's requested
24 level of incentive compensation.

1 ▪ PacifiCorp's incentive compensation plan includes financial objectives
2 that, in the past, have been excluded from ratemaking.
3 ▪ A number of the incentive plan objectives are to complete work-related
4 tasks that should be expected, or are required as a normal course of
5 work and, therefore, do not represent achievement beyond the
6 expected performance.
7 ▪ PacifiCorp has provided the scorecards used to evaluate incentive
8 compensation. Of the 14 scorecards provided for 2005, all but one
9 scorecard includes a rate case objective.
10 ▪ The incentive amount included is 70% of the maximum potential
11 amount, which means the estimate exceeds target levels allegedly
12 required to make compensation competitive at the expense of the
13 ratepayers.
14 ▪ The Company does not view incentive compensation as extra
15 compensation and/or totally at risk, but rather a means to bring
16 employee pay to a comparable level in the marketplace.
17 **Q. REGARDING YOUR FIRST POINT ON FINANCIAL OBJECTIVES,**
18 **WHAT PORTION OF THE INCENTIVE PLAN IS FINANCIAL?**
19 A. The various scorecards range from 10% to 100% for the "Financial"
20 category. A simple average of the 14 scorecards for 2005 is 27.5%. In
21 other words, 27.5% of the incentive plan is based upon meeting financial
22 objectives.
23

1 **Q. YOU STATED THAT SCORECARDS ARE USED TO DETERMINE THE**
2 **LEVEL OF COMPENSATION THAT SHOULD BE AWARDED. WOULD**
3 **YOU PLEASE EXPLAIN THE SCORECARDS?**
4 A. A scorecard is similar to the report card you would receive while you were
5 in school. The scorecard measures performance. The scorecard for each
6 of the business units has 4 categories. The categories are financial,
7 stakeholder/customer, employee and process. Each category has one or
8 more objectives and each objective has a means of assessment referred
9 to as a "metric" with a weighting for each objective. A score is determined
10 and the weighting is applied, resulting in an overall perceived level of
11 achievement.
12 **Q. WHY HAVE FINANCIAL OBJECTIVES BEEN EXCLUDED IN THE**
13 **PAST?**
14 A. In past rate cases, the Commission has excluded financial goals from
15 rates because shareholders are the primary benefactor of the Company
16 achieving the financial goal.
17 **Q. DO THE OBJECTIVES OF INCENTIVE COMPENSATION FOR**
18 **EMPLOYEES PROVIDE A CLEAR BENEFIT TO RATEPAYERS?**
19 A. No. For example, of the 14 scorecards provided by PacifiCorp for 2005 to
20 evaluate incentive compensation, all but one scorecard includes a rate
21 case objective. If a rate case objective is met, an employee receives extra
22 compensation. This is a clear benefit to shareholders, but it is very
23 unclear if ratepayers benefit if the objective is met. They may, in fact, be

1 harmed. In Docket No. 90-035-06, the Commission stated an incentive
2 plan should be tied to performance measures directly benefiting
3 ratepayers if ratepayers are asked to fund it. For that reason, the
4 Committee does not believe ratepayers should have to fund incentive
5 compensation for meeting rate case objectives.

6 **Q. IS THIS ISSUE PRESENTED DIFFERENTLY THAN IN PREVIOUS**
7 **DOCKETS?**

8 A. Yes. My review of the Company's incentive plans in previous dockets
9 suggested the plans were designed to reward for outstanding performance
10 and increased shareholder value. However, in this current rate case, the
11 Company states that employees meeting an expected level of
12 performance alone will be rewarded with incentive compensation.

13 **Q. WHAT ARE SOME WORK TASKS THAT YOU WOULD EXPECT AN**
14 **EMPLOYEE TO MEET WITHOUT INCENTIVE COMPENSATION?**

15 A. Some required tasks in the incentive compensation plan include:
16 completion of continuing education requirements; completing data
17 requests on time; ensuring all processes are adequately documented and
18 controlled (a Sarbanes Oxley requirement); updating emergency
19 communications plans; completing the Sarbanes Oxley project; and
20 reducing environmental risks. These are tasks that an employee should
21 perform without additional incentive compensation.

22

1 **Q. DOES PACIFICORP VIEW INCENTIVE PAY AS A SUPPLEMENTAL**
2 **FORM OF COMPENSATION?**
3 A. No. The Company does not view incentive compensation as
4 supplemental employee compensation, nor does it consider it totally at
5 risk.
6 **Q. WHAT IS YOUR BASIS FOR CLAIMING THAT THE COMPANY DOES**
7 **NOT VIEW INCENTIVE COMPENSATION AS ADDITIONAL**
8 **COMPENSATION THAT IS AT RISK?**
9 A. In response to DPU Data Request 1.14, the Company states:
10 Annual incentives are not 'extra compensation' when one
11 examines the average compensation paid in the
12 marketplace.
13
14 Clearly, the Company does not view incentive compensation as extra
15 compensation. On the contrary, the reference to average compensation in
16 the marketplace suggests PacifiCorp believes that the incentive
17 compensation is merely a way to bridge employees' pay with what they
18 could expect to be paid in the marketplace.
19 The response to DPU 1.14 also states: "The annual incentive
20 programs are intended to put some of the competitive total remuneration
21 at risk." The statement suggests incentive compensation may be at risk,
22 but the same response also states: "However, given expected
23 performance, employees can earn total cash compensation that is
24 competitive in the marketplace." This statement clearly indicates that
25 PacifiCorp believes there is little risk in employees earning the full

1 incentive compensation. As indicated above, the Committee does not
2 believe payment of incentive compensation for expected performance is
3 appropriate.

4 **Q. WHY DOES THE 70% OF THE MAXIMUM POTENTIAL INCENTIVE**
5 **COMPENSATION EXCEED THE TARGET INCENTIVE LEVEL?**

6 A. In its response to DPU Data Request 10.1, PacifiCorp indicated that the
7 incentive amount included is 70% of the maximum potential amount. If the
8 70% is allowed, the PacifiCorp employee compensation included in rates
9 will exceed the average market level of pay by 20%. The Company's
10 purported justification for incentive compensation is that it is required to
11 bring the pay of PacifiCorp employees to the level paid in the market. To
12 achieve the market level of pay employees are supposedly required to
13 perform at the target level or at a 50% performance rate. If the 70%
14 payout is allowed, then payment will exceed that required (i.e. the 50%) to
15 compensate employees at the market level.

16 **Q. WHY DO YOU BELIEVE THIS SHOULD BE DISALLOWED?**

17 A. This should be disallowed for two reasons. First, because this method
18 allows employees to be paid beyond what has been determined to be a
19 competitive wage. Second, by allowing incentive compensation based on
20 a 70% performance rate, there is an assumption that the employees of
21 PacifiCorp have performed at a level that exceeds expectations. It is not
22 appropriate to require ratepayers to assume the risk that this "above

1 normal" level of achievement will occur without reflecting some benefit
2 (i.e. expense reduction) in the filing.

3 **Q. PLEASE EXPAND ON THE COMPANY'S CLAIM THAT BASE PAY**
4 **AND MEETING THE TARGET INCENTIVE LEVEL RESULTS IN**
5 **AVERAGE COMPETITIVE COMPENSATION.**

6 A. The claim that base pay plus incentive pay equals the average
7 marketplace compensation is not uncommon. For example, that claim
8 was made in a current proceeding in Vermont. Although incentive
9 compensation is typically part of a utility's total wage package, for
10 PacifiCorp to claim that the incentive compensation is appropriate and that
11 it should be included in rates because target performance results in
12 average marketplace compensation is not enough. Even though the
13 surveys relied on by the Company may support a level of compensation,
14 they do not justify that same level of compensation should be included in
15 PacifiCorp's rates. This is because the comparative company
16 compensation that is used as justification is not totally allowed in rates by
17 public utility commissions. Therefore, if the 70% or even the 50% target
18 level is allowed in rates, the average compensation in rates for PacifiCorp
19 employees may exceed the competitive level of compensation allowed in
20 the rates of utilities in other jurisdictions.

21 **Q. ARE THERE OTHER FACTORS TO BE CONSIDERED WHEN**
22 **DETERMINING WHAT LEVEL OF INCENTIVE COMPENSATION**
23 **SHOULD BE INCLUDED IN RATES?**

1 A. Yes. Base pay continues to be increased by some percentage on an
2 annual basis. Incentive compensation came about as additional
3 compensation that was purported to be at risk. The only real risk at
4 PacifiCorp is whether the added compensation will not increase above the
5 previous year's level. In Docket No. 97-035-01, the Utah portion of
6 incentive compensation for PacifiCorp was approximately $4.4 million. In
7 Docket No. 99-035-10, the Utah portion of incentive compensation was
8 approximately $6 million. In the current filing, the Utah portion of incentive
9 compensation is approximately $11 million. If incentive compensation
10 continues to go unchecked and allowed simply because the Company
11 claims it is reasonable, ratepayers will be significantly burdened with costs
12 that have not been justified.

13 **Q. WHY DO YOU CONTEND THE COSTS HAVE NOT BEEN JUSTIFIED?**

14 A. The payment of incentive compensation can only be justified if a
15 measurement of benefit and improvement can be shown and it can be
16 demonstrated that the level paid is not excessive. If previous goals have
17 been achieved, the bar must be raised to provide incentive for more
18 improvement. If the goal cannot be increased, new goals must be
19 introduced. Normal job performance requirements do not justify additional
20 financial remuneration above and beyond the increase in base wages.

21 **Q. BASED ON THESE FACTORS, WHAT IS THE COMMITTEE'S**
22 **RECOMMENDATION REGARDING THE AMOUNT OF INCENTIVE**
23 **COMPENSATION REFLECTED IN THE FILING?**

1 A. The Committee recommends incentive compensation be reduced on a
2 total Company cost basis by $16,701,895 or $5,679,150 on a Utah
3 expense basis. This adjustment represents a 50% reduction in the
4 amount being requested in the Company's filing.

5 **Q. WHY DID YOU REMOVE FIFTY PERCENT OF INCENTIVE**
6 **COMPENSATION?**

7 A. Despite the fact that I am not convinced that the current level of incentive
8 compensation provides a real benefit to ratepayers, I have conservatively
9 assumed some benefit has been derived from some performance that is
10 over and above that which is expected. On that presumption, I am
11 recommending that the risk and cost associated with this unidentified
12 benefit should be shared equally between ratepayers and shareholders.
13 This recommendation is consistent with the California Public Utilities
14 Commission's decision in D.00-02-046, at page 259, where the
15 Commission stated that:

16 "We find no compelling evidence for a change in our current
17 practice of allowing 50% recovery of <u>targeted</u> <u>incentives</u> from
18 ratepayers. As we have held, shareholders and ratepayers alike
19 benefit from the good performance that incentive programs such as
20 PIP seek to encourage. We continue to believe that equal sharing
21 of costs is fair, and that it provides appropriate incentives to the
22 utility to perform in ways that benefit ratepayers and shareholders
23 alike. Moreover, since the actual payout is less than the target
24 payout in any year when employees do not perform well enough to
25 earn targeted payouts, there is an unacceptable risk of
26 overcollection of costs in the test year if we allow the inclusion of
27 100% of the targeted payout in rates. Continuing our policy of
28 allowing 50% of <u>targeted</u> <u>payouts</u> mitigates this concern."
29 (Emphasis added)
30

1 Our recommendation is consistent as it removes 50% of a 70% payout.
2 This results in a future test year expense reduction of $5,679,152 on a
3 Utah basis.

4 **BASE PAYROLL**

5 **Q. PLEASE EXPLAIN THE ADJUSTMENT TO THE BASE PAYROLL**
6 **AMOUNT REQUESTED BY THE COMPANY.**

7 A. In the 2006 Test Year, the Company assumed 488 additional employees
8 would be on the payroll. The Company's supporting information, reflected
9 in the labor escalation file for JTW-1, show that 376 of the projected 488
10 additional positions are to be filled by March 2005. The supporting
11 information also shows that PacifiCorp anticipated 355 of the 488
12 additional positions would have been filled by August 2004. As of August
13 2004, only 80 of the 355 additional positions have been filled.

14 **Q. IS THE COMPANY'S PROJECTED TEST YEAR NUMBER OF**
15 **EMPLOYEE ADDITIONS REASONABLE?**

16 A. No. The number of projected employee additions is excessive and overly
17 optimistic in light of the actual number of employees recently hired. In
18 addition, the requested employee increase is not known and measurable.

19 **Q. WHY DO YOU BELIEVE THAT THE ADDED EMPLOYEES ARE NOT**
20 **KNOWN AND MEASURABLE?**

21 A. It is not known that 488 positions will be added. The Company projected
22 that as of August 2004, 355 positions would have already been added, but
23 only 80 were added. Therefore, only 80 new positions are known and

1 measurable as of August 2004. Also, if the Company continues to hire at
2 the rate it has in the past, 264 of the 488 positions would still not be filled
3 by 2006. The requested number of additions is not measurable because
4 the positions added do not comport with the positions the Company
5 projected.
6 For example, by August 2004, 46 IBEW 57 PS positions were
7 projected to be added, but in August, the IBEW 57 PS complement
8 actually decreased by 24 positions. By August 2004, 102 exempt
9 positions were to be added to Power Delivery, but in August, the
10 complement of Power Delivery employees decreased by 11. Without
11 knowing with some degree of reasonableness the actual positions that will
12 be added and their respective compensation, the Company's request is
13 purely speculation. Simply put, the Company's employee additions (year
14 to date) are significantly below the projected level included in the filing,
15 and when PacifiCorp does add employees, it has not added the ones it
16 said it would be adding. Allowing the addition of the Company's requested
17 488 positions in rates would result in the recovery of costs the Company is
18 not likely to incur during the future test period.
19 **Q. ARE YOU AWARE OF ANY REASON WHY THE HIRING HAS NOT**
20 **TAKEN PLACE?**
21 A. According to the response to CCS 23.17, the Company has implemented
22 a "Hiring Frost" or slowdown in hiring. Managers have been asked to

1 defer or eliminate incremental hiring activity to meet efficiency targets in
2 the FY 2005 budget.

3 **Q. BASED ON THESE FACTS, DO YOU BELIEVE THAT THE LEVEL OF**
4 **BASE PAYROLL EXPENSE IN THE TEST YEAR NEEDS TO BE**
5 **SIGNIFICANTLY ADJUSTED?**

6 A. Yes.

7 **Q. HOW DID YOU DETERMINE YOUR RECOMMENDED ADJUSTMENT?**

8 A. I made a comparison of the year-to-date actual employee count increase
9 to the projected increase to estimate the fiscal year ending March 31,
10 2006 employee complement. My adjustment eliminates 264 of the 488
11 projected employee additions. That means that I am recommending the
12 allowance of the 80 actual additions as of August 2004, plus an estimated
13 144 additional positions to be included in the Test Year. In making an
14 adjustment, I multiply the recommended reduction of 264 positions by the
15 average compensation of the Company's 488 projected additions.

16 **Q. BASED ON THESE FACTORS, WHAT DOES THE COMMITTEE**
17 **RECOMMEND FOR THE PAYROLL ADJUSTMENTS?**

18 A. As shown on CCS Exhibit 2.1, the Committee recommends a reduction of
19 $17,950,722 in base payroll expense, or $6,200,518 on a Utah basis.

1 **PAYROLL TAX EXPENSE**

2 **Q. DOES THIS REDUCTION IN EMPLOYEE LEVELS ALSO IMPACT**
3 **PAYROLL TAX EXPENSE?**

4 A. Yes. As shown on CCS Exhibit 2.2, the payroll tax expense needs to be
5 reduced by $2,326,940 on a total Company basis and $803,770 on a Utah
6 basis to reflect the associated impact of removing the 264 employee
7 additions that are not known and measurable.

8 **EMPLOYEE BENEFITS**

9 **Q. YOU ARE ALSO PROPOSING ADJUSTMENTS FOR EMPLOYEE**
10 **BENEFITS. PLEASE IDENTIFY THESE ADJUSTMENTS.**

11 A. In my adjustments I have reflected the reductions to medical insurance,
12 dental insurance, vision insurance, life insurance, long-term disability,
13 workers compensation and other benefits commensurate with the
14 reduction in employees that I have recommended. Also, the 401(k)
15 expense was reduced based on the effective contribution rate applied to
16 the recommended compensation reduction. The recommended reduction
17 to benefits expense, as shown on CCS Exhibit 2.3, is $3,643,925 on a
18 total Company basis and $1,258,679 on a Utah basis. This adjustment is
19 based on the employee reduction recommendation presented above.

20 **Q. HOW WERE THE VARIOUS BENEFIT ADJUSTMENTS RELATING TO**
21 **EMPLOYEE BENEFITS CALCULATED?**

22 A. For each of the respective benefits adjusted, excluding 401(k), I took the
23 Company's projected cost and divided it by the projected employee

1 complement of 6,578 to determine the cost per employee. That per
2 employee cost was then multiplied by my recommended reduction of 264
3 employees to determine an employee benefit adjustment. The 401(k)
4 adjustment was determined by dividing the projected 401(k) expense by
5 total payroll to get the effective 401(k) contribution rate. The effective
6 calculated rate was multiplied by the payroll adjustment to determine the
7 reduction to 401(k) costs. The respective calculations are reflected on
8 CCS Exhibit 2.3.

9 **Q. ARE YOU RECOMMENDING ANY ADDITIONAL ADJUSTMENTS TO**
10 **EMPLOYEE BENEFITS?**

11 A. Yes. According to Mr. Rosborough's testimony, the Company pays for
12 91% of medical benefits. In response to UIEC 2.14, the Company stated
13 that a Hewitt Associates survey of 17 utilities in 2004 showed that on
14 average employers pay 84% of the costs. The response indicates that
15 PacifiCorp is in a transition to a 90%/10% cost sharing in calendar 2005. I
16 believe that target of 90% is inappropriate. Not only is the PacifiCorp plan
17 more generous than a small sample of utilities, it is significantly more
18 generous than the national average[1].

19 **Q. WHAT FINAL ADJUSTMENT ARE YOU RECOMMENDING IN**
20 **RELATION TO EMPLOYEE BENEFITS?**

21 A. As shown on CCS Exhibit 2.4, I recommend medical expense be reduced
22 by an additional $2,975,449 on a total Company basis and $1,027,776 on

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[1] A response to a data request from Central Vermont Public Service Corporation in Docket No. 6946 and 6866 referenced a Hewitt Associates; Health Initiative 2003 study that indicated that the 2003 national average employee contribution for medical to be 19%.

1 a Utah basis. The adjusted medical costs of $44,631,734 were divided by
2 90% and then multiplied by 84% to arrive at a recommended total
3 Company cost of $41,656,285 as shown on line 203, of CCS Exhibit 2.4.

4 **WORKING CAPITAL**

5 **Q. WHY HAVE YOU REMOVED CERTAIN COMPONENTS OF THE**
6 **WORKING CAPITAL CALCULATION?**

7 A. A lead/lag study is used to incorporate the majority of the working capital
8 requirements of the Company. Such a study was included in the
9 Company's rate case filing. The calculated working capital represents the
10 cash required to fund the day-to-day operations of the Company. To
11 include a cash balance over and above the requirement based on a
12 lead/lag study is the equivalent of a double count. As shown on CCS
13 Exhibit 2.5, I recommend decreasing working capital by $5,660,202, on a
14 Utah basis, so that the cash working capital level comports with the lead
15 lag study.

16 **Q. PLEASE EXPLAIN WHY "OTHER ACCOUNTS RECEIVABLE**
17 **ACCOUNT 143" IS BEING REMOVED.**

18 A. The delay in collections associated with the provision of utility service is
19 accounted for in the lead lag study. Account 143 does not represent
20 receivables from customers and should be excluded from the working
21 capital determination. This account is supposed to be maintained to
22 reflect subscriptions to capital stock and employee receivables. This

1 account is not appropriate for recognition in the working capital
2 requirement. A reduction of $5,834,737 on Utah basis is recommended.
3 **Q. WHY DID YOU INCREASE THE WORKING CAPITAL REQUIREMENT**
4 **BY REMOVING ACCOUNTS PAYABLE?**
5 A. I assume the accounts payables of $3,195,908 that I recommend
6 removing are either accounted for in the lead lag study or are not utility
7 related. On that assumption, I recommended the working capital
8 requirement be increased by $3,195,908 on a Utah basis by removing the
9 liabilities from the calculation. This adjustment to working capital is
10 shown on my CCS Exhibit 2.5, and is reflected in the overall summary
11 testimony presented by Donna DeRonne.
12 **Q. PLEASE EXPLAIN WHY YOU LEFT THE OTHER DEFERRED**
13 **CREDITS, THE ASSET RETIREMENT AND THE ARO REGULATORY**
14 **LIABILITY IN THE WORKING CAPITAL DETERMINATION.**
15 A. It is my understanding that these costs were not considered in the lead lag
16 analysis and because they were not, they require recognition in the
17 working capital requirement determination.

18 **<u>DIRECTORS & OFFICERS LIABILITY INSURANCE</u>**
19 **Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO THE LEVEL OF**
20 **DIRECTORS AND OFFICERS LIABILITY INSURANCE INCLUDED IN**
21 **THE TEST YEAR?**
22 A. Yes. The purpose of Directors and Officers (D&O) liability insurance is to
23 provide protection to shareholders from management's missteps or

1 improprieties in running the utility business. Shareholders elect
2 PacifiCorp's Board of Directors who is responsible for appointing the top
3 management (officer level) positions within the company. Directors and
4 Officers are compensated to make good business decisions, provide
5 quality leadership and serve with integrity. Ratepayers have no choice in
6 who manages the Company and who serves on the Board of Directors.
7 Moreover, insurance companies do not compensate ratepayers for losses
8 resulting from poor business decisions or improprieties by management.
9 Therefore, the cost associated with the protection of the shareholders'
10 investment should be entirely borne by shareholders.

11 **Q. WHAT INCREASES IN D&O LIABILITY INSURANCE EXPENSE HAS**
12 **PACIFICORP EXPERIENCED AND WHY?**

13 A. Since 2002, PacifiCorp has experienced a significant increase in the
14 amount of D&O liability insurance expense. Large increases in D&O
15 liability insurance premiums has been typical across the nation and is
16 attributable to the recent accounting scandals of entities such as Enron,
17 Global Crossing, Qwest, and WorldCom. In addition, PacifiCorp's 60%
18 increase in coverage levels –from $100 million to $160 million—has
19 contributed to its significant increase in the annual level of D&O insurance
20 expense.

21 As shown on CCS Exhibit 2.6, the D&O liability insurance expense
22 for PacifiCorp was $328,788 in fiscal year 2001. After a modest 0.09%
23 increase in expense in fiscal year 2002 to $329,110, the cost jumped

1 116% to $711,877 in 2003. Between 2003 and 2004, the D&O liability
2 insurance expense increased by 98.3% to $1,411,888. Thus, the D&O
3 liability insurance is 429% higher in fiscal year 2004 compared to fiscal
4 year 2002.

5 **Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING TO THE EXPENSE**
6 **INCLUDED IN THE TEST YEAR FOR D&O LIABILITY INSURANCE?**

7 A. Utah ratepayers should not be required to pay for D&O insurance that
8 protects PacifiCorp shareholders from missteps or improprieties by
9 management in running the business. The D&O liability insurance directly
10 benefits shareholders; therefore, the entire insurance cost should be
11 borne by shareholders. CCS Exhibit 2.6 removes the entire amount of the
12 D&O insurance expense from the test year. My recommended adjustment
13 reduces test year expense by $1,355,000 on a total company basis and
14 $563,798 on a Utah basis. My proposed adjustment effectively insulates
15 Utah ratepayers from the sharp increase in costs caused by the recent
16 accounting scandals and PacifiCorp's significant increase in coverage
17 levels.

18 **WAPA WHEELING ADJUSTMENT**

19 **Q. WHAT IS YOUR FINAL ADJUSTMENT?**
20
21 A. My final adjustment relates to the wheeling services provided by
22 PacifiCorp (originally Utah Power) to the Western Area Power
23 Administration (WAPA) under a long-term contract.

1 **Q. PLEASE PROVIDE SOME BACKGROUND ON THE WAPA ISSUE.**
2 Since the Commission's order in Docket No. 82-035-13, issued May 23,
3 1983, additional revenues have been imputed to the wheeling services
4 provided by the Company to WAPA. In 1962, Utah Power entered into an
5 80-year contract in 1962 to provide wheeling services to WAPA. That
6 contract called for a fixed kilowatt-year rate, which was lower than the
7 current authorized FERC wheeling rate. The Commission imputed
8 additional revenues consistent with the applicable current FERC rate,
9 which is presently $24.30 per kilowatt year. In prior rate cases the
10 Company has objected to this adjustment and not included it as a pro
11 forma revenue adjustment. The Commission has previously rejected the
12 Company's arguments relating to not including the pro forma revenue in
13 determining base rates for PacifiCorp.
14 **Q. WHAT HAS THE COMPANY DONE IN THIS CASE?**
15 A. In the current case, the Company has made similar arguments for not
16 imputing additional wheeling revenues for the WAPA service.
17 The arguments for not imputing additional revenue to the WAPA contract
18 are contained in the direct testimony of J. Ted Weston. The first argument
19 Mr. Weston advances is that the revenues are compensatory. Mr. Weston
20 states that the actual 2003 wheeling revenues were $2,819,275. He then
21 proceeds to argue that the operating and maintenance cost of the WAPA
22 contract is approximately 10% of the cost of maintaining the "Utah control
23 load served by PacifiCorp." That total maintenance cost is $1,825,690 in

1 2003, according to Mr. Weston. He thus allocates 10% of this dollar
2 amount, or $183,000 to the WAPA revenues and concludes that the net of
3 approximately $2,636,000 was available to contribute to fixed costs. He
4 then concludes that "…the assets serving the WAPA contract are more
5 than 42 years old and largely depreciated, this contribution exceeds
6 current fixed costs."

7 **Q. HOW DO YOU VIEW MR. WESTON'S ANALYSIS?**

8 Mr. Weston's analysis flies in the face of traditional utility ratemaking.
9 First, Mr. Weston assigns only the average maintenance and operating
10 costs that are 10% of the total maintenance and operating cost to the
11 WAPA contract. It is a normal ratemaking practice to charge all customers
12 average cost regardless of when and how they take service. However, he
13 then assigns only the cheapest and oldest assets, those that are "more
14 than 42 years old," as only serving WAPA. Clearly, there are PacifiCorp
15 customers that could argue that they have been on the system for 42
16 years or longer and the assets that serve them are, or will be, fully
17 depreciated. Those customers could argue that they should be treated
18 differently than other residential, commercial or industrial customers and
19 receive a lower rate because of their length of time receiving service on
20 the system. They could also then argue that even though their assets are
21 old and dilapidated they should only receive the average cost of
22 maintaining those assets as Mr. Weston has argued should be allocated
23 to the WAPA contract. Clearly, the Commission would not accept this

1 argument if it were advanced on behalf of a residential, commercial or
2 industrial customer. It, therefore, cannot be accepted on behalf of a
3 wheeling customer as a basis of providing less than the current authorized
4 FERC rate.

5 **Q. WHAT IS THE SUBSEQUENT ARGUMENT MADE BY MR. WESTON?**

6 A. The next argument advanced by Mr. Weston is essentially the same as
7 the one previously rejected by the Commission. That argument is that
8 because the WAPA contract limits WAPA from receiving Point-to-Point
9 and Network service and limits service to the use of only those points of
10 interconnection and points of delivery listed in the contract, WAPA may
11 not substitute alternative sources or deliver its energy to alternative points.
12 According to Mr. Weston, this allows the Company to utilize short-term
13 transmission marketing over the Open Access Same-time Information
14 System (OASIS) to generate additional wheeling revenues based the
15 short-term availability of the WAPA capacity on the transmission system.
16 Mr. Weston argues that Utah was allocated $4,597,115 of the total short-
17 term revenues generated by PacifiCorp of approximately $11 million, and
18 therefore, the imputation of additional revenues to WAPA to bring them to
19 compensatory rates should not be made.

20 **Q. DOES THE COMPANY'S ARGUMENT DIFFER FROM THE ARGUMENT**
21 **MADE IN PAST RATE CASES?**

22 A. Essentially, this is the same argument that has been made by PacifiCorp
23 in prior dockets and rejected by the Commission. On page 23 of the

1 Order in Docket No. 99-035-10, the Commission stated that the basis for
2 the Company's opposition to the proposed imputation is its assertion that
3 the WAPA contract enables a flow of transmission-related benefits to retail
4 customers.
5 Further on in the same decision, at page 25, the Commission
6 states: "We are unable to agree that the benefits allegedly enabled by
7 these contracts outweigh cost ratepayers, in the absence of an imputation
8 of revenues, would bear because of them."
9 **Q. WAS THE COMPANY ASKED TO PROVIDE SUPPORT FOR THE**
10 **REVENUES IT CLAIMS ARE GENERATED AS A RESULT OF THE**
11 **WAPA CONTRACT'S SHORT-TERM WHEELING REVENUES?**
12 A. Yes, it was. In CCS Data Request 3.107, PacifiCorp was asked to show
13 exactly what portion of the amounts of short-term wheeling revenues
14 generated from Mona, Four Corners and Glen Canyon resulted from
15 capacity transmission available, but not utilized by WAPA. The response
16 was, in part, as follows:
17 It is not possible to show exactly what portion of the above
18 listed revenue amounts are a result of PacifiCorp's
19 marketing of transmission capacity that WAPA could have
20 been utilizing. WAPA currently has no remarketing or
21 alternate use rights under the WAPA contract and PacifiCorp
22 cannot speculate how it may have used its rights if such
23 service had been awarded to WAPA as a Point-to-Point
24 service under the OATT.
25
26 Clearly, the Company is speculating that there is some benefit, which
27 offsets the discount afforded through the WAPA contract.

1 **Q. BASED ON THIS ANALYSIS, WHAT IS THE COMMITTEE'S**
2 **RECOMMENDATION ON THE WAPA REVENUES?**
3 A. The Committee believes the Commission should continue to impute these
4 revenues consistent with the current FERC wheeling rate and reject, once
5 again, the same argument that the Company made in past rate cases. My
6 recommended adjustment of $1,880,771 on a Utah basis is reflected on
7 CCS Exhibit 2.7.
8 **Q. DOES THIS CONCLUDE YOUR PREFILED TESTIMONY?**
9 A. Yes, it does.