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

STIPULATION TESTIMONY OF D. DOUGLAS LARSON

OCTOBER 12, 2004

Q. Please state your name.

A. My name is D. Douglas Larson.

Q. Did you previously offer testimony in this proceeding?

A. Yes, I have previously filed testimony as part of the Company's direct case.

Purpose and Summary of Testimony

Q. What is the purpose of your testimony?

A. Consistent with Utah statutes, the Company proposed a future test year in this case that begins on April 1, 2005 and ends on March 31, 2006. This twelve-month test period corresponds with the Company's 2006 Fiscal Year (FY) and is the test period that is adopted in the Test Period Stipulation ("Stipulation") before the Commission. The purpose of my testimony is to explain why this test period best reflects the conditions the Company expects to experience in the rate effective period.

Q. Under applicable Utah statutes, how is the test year for a utility general rate case determined?

A. In 2003, the Utah Legislature amended section 54-4-4(3) of the Utah utility code. The earlier version of subsection 3 allowed the Commission to adopt a future test period not to exceed twelve months from the date of filing.

The current language of subsection (3) states:

> (a) If in the commission's determination of just and reasonable rates the commission uses a test period, the commission shall select a test period that, on the basis of the evidence, the commission finds best reflects the conditions that a public utility will encounter during the period when the rates determined by the commission will be in effect.
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> (b) In establishing the test period determined in Subsection (3)(a), the commission may use:

(i) a future test period that is determined on the basis of projected data not exceeding 20 months from the date a proposed rates increase or decrease is filed with the commission under Section 54-7-12;

(ii) a test period that is:

(A) determined on the basis of historic data; and

(B) adjusted for known and measurable changes; or

(iii) a test period that is determined on the basis of a combination of:

(A) future projections; and

(B) historic data.

(c) If pursuant to this Subsection (3), the commission establishes a test period that is not determined exclusively on the basis of future projections, in determining just and reasonable rates the commission shall consider changes outside the test period that:

(i) occur during a time period that is close in time to the test period;

(ii) are known in nature; and

(iii) are measurable in amount.

Subsection 3 establishes that the standard that governs the Commission's selection of a test period is that it best reflects the conditions that a public utility will encounter when the rates are in effect.

Q. When will the rates likely become effective in this case?

A. Given their complexity, it is typical for orders in general rates cases to become effective near the end of the statutory 240-day period under section 54-7-12(3). Given the fact that this case was filed on August 4, 2004, it is likely that the rates in this case will become effective on April 1, 2005, the same time that the projected test period would commence. In other words, the immediate period following the effective date of the rates in this case and the test period will precisely match each other. Thus, consistent with the new language of section 54-4-4(3), the commencement of the rate-effective period and the commencement of the test period will match each other in this case.

Q. Why is it important that the test period and the rate effective period closely match each other?

A. As the Commission has noted many times, one of the critical underlying principles that govern rate proceedings is the effort to match capital, expenses, and revenues in a test period. A similar matching concept also suggests that, to the extent possible, the rate-effective period and the test period should match each other. Without that type of matching, a utility, like PacifiCorp, which is facing rapid expansion and growth will not have a reasonable opportunity to earn its authorized cost of capital.

Q. Please explain why the FY 2006 test period adopted in the Stipulation best reflects the conditions PacifiCorp will face during the rate effective period.

A. The Company requires additional dollars not currently reflected in rates. With the rapid growth of the system, the implementation of new approaches to asset management and the implementation of the recommendations from the Storm Report, it is clear to me that the only test period that can adequately reflect this needed expenditure, is the one that includes a clear assessment of the operation maintenance and capital costs PacifiCorp must incur in order to deliver these initiatives and meet all of the objectives it faces in the near future. A considerable investment, certainly large by historical standards, is required to ensure that we continue to provide safe, reliable, cost-effective electric service to our Utah customers. The test period that "best reflects" these conditions is one that takes full account of these changing circumstances. The FY 2006 future test year is the test year capable of meeting this need and properly reflecting for rate setting purposes the costs the Company must incur in the rate effective period to provide the level of service it is planning for its customers.

Q. Are there other issues that show that the 2006 FY test period "best reflects" the rate effective period?

A. Yes. The Company's financial strength is critical to its ability to make these substantial investments in a cost effective manner. In order to continue to attract investment at competitive rates, the Company must be able to demonstrate to the financial community that it has a fair opportunity to earn its authorized rate of return. In a time of significant growth, the failure to allow the Company to reflect these changing conditions in rates sends a clear signal to the financial markets that the Company cannot earn its allowed rate of return. A Commission determination adopting the 2006 FY test period will provide the Company with a reasonable opportunity to earn its authorized return while providing customers with safe and reliable service at reasonable prices.

Q. Is there another test period available in this case which, in the Company's view, can adequately reflect the conditions that will be in place during the rate effective period?

A. No. While in other circumstances this may not be the case, I believe that there is a compelling argument that the 2006 FY test period best reflects the conditions that the Company will encounter. Put simply, historical or even "hybrid" test periods cannot accurately reflect the significant programs and activities that are planned for the rate effective period. The only test period that can accurately reflect this significant investment and development of programs and initiatives is one that takes into account the costs required to perform these activities.

Q. Why wouldn't a test year based on historic data with known and measurable changes capture the increasing costs you have discussed?

A. Modest increases over historic levels can be identified and captured through known and measurable adjustments. When conditions in the rate effective period are expected to differ dramatically from historic experience (as is the case in this proceeding), the only logical approach is to forecast all of the interrelated components of revenue requirement in order to avoid the possibility of significant mismatches.

Q. Has the preparation of the Company's future test year forecast in this case been closely scrutinized?

A. Yes. There has been great attention to detail in the preparation of this forecast. Every effort has been made to validate the data, and we have worked hard to maintain regulatory principles such as matching revenues and expenses and to provide an appropriate audit trail. Throughout the preparation of the forecast, we have used a "bottom-up" approach to ensure that the business units that will actually be spending the dollars in FY 2006 to build, operate and maintain the system are in agreement with the projected levels of expenditure.

Q. Since the forecast test year revenues, net power costs and many allocation factors are calculated based on customer load forecasts, how sensitive is the test year revenue requirement to variations in forecast loads?

A. I have prepared Exhibit UP&L Stipulation 1 to show the impact on the forecast test year revenue requirement of a 2% variation in the load forecast. Two percent is well within the Company's historical margin of error for short-term load forecasting. As Exhibit UP&L Stipulation 1 shows, a load forecast error of plus or minus 2% would change the forecast Utah revenue requirement by less than $3 million. This analysis provides additional assurance of the Company's ability to produce a reliable forecast test year and to match associated costs and revenues.

Q. By adopting the stipulated FY 2006 test year, would the Commission also be accepting all of amounts reflected in the Company's filing?

A. No. There may be differences of opinion about the proper application of forecasting techniques and the calculation of individual inputs into the revenue requirement. Such differences are inevitable in a general rate case where the parties have different perspectives. The Stipulation specifically provides that all those issues can be raised in this case.

Q. Do you have any other general observations about the use of a future test year?

A. The Commission is required by statute to choose the test period that best reflects the conditions in the rate effective period. The Utah Legislature has explicitly made a future test year option available to the Commission; and, in fact, the future test year is the first of the three options listed. The use of a forecast test year is most compelling when costs are changing dramatically (up or down) from historic levels. PacifiCorp now finds itself in a period where both capital and O&M costs are increasing significantly to meet growing customer demand for electricity. I believe that PacifiCorp's current circumstances are a perfect example of the need for a future test year that was anticipated by the Legislature and that the FY 2006 test period is the test period that best reflects the circumstances that PacifiCorp will face in the rate effective period.

Q. Does this conclude your testimony?

A. Yes.