BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of MidAmerican Energy Holdings Company and PacifiCorp dba Utah Power & Light Company for an Order Authorizing Proposed Transaction	)	**DOCKET NO. 05-035-54** **Exhibit No. DPU 1.0** **Direct Testimony of** **Charles E. Peterson**

FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

December 2, 2005

CONTENTS

I. INTRODUCTION AND SUMMARY ……..…………………………………… 1

II. LOCAL STAFFING ………………………………………………………... 5

III. CORPORATE PRESENCE/EXECUTIVE DECISION-MAKING …………………… 7

IV. AUDIT ISSUES ………………………………………………………... 8

V. SERVICE QUALITY/CUSTOMER GUARANTEES ………………………………… 9

VI. GENERATION AND TRANSMISSION ISSUES ……………………………………. 11

VII. FEDERAL AND STATE REGULATION ……………………………………………. 11

VIII. COMMUNITY ISSUES ……………………………………………………….. 14

IX. RING-FENCING ………………………………………………………………. 14

X. BENEFITS ………………………………………………………………... 19

XI. COSTS ……………………………………………………………………. 26

XII. RECOMMENDATIONS ……………………………………………………. 29

Testimony of Charles E. Peterson

I. INTRODUCTION AND SUMMARY

Q: Please state your name, business address and title.

A: My name is Charles E. Peterson; my business address is 160 East 300 South, Salt Lake City, Utah 84114; I am a Utility Analyst in the Division of Public Utilities.

Q: On whose behalf are you testifying?

A: The Division of Public Utilities ("Division").

Q: Please summarize your educational and professional experience.

A: I attended the University of Utah and earned a B.A. in mathematics in 1978 and a Master of Statistics (M.Stat.) through the Graduate School of Business in 1980. In 1990 I earned an M.S. in economics, also from the University of Utah.

Between 1980 and 1991 I worked as an economic and financial consultant and business appraiser for several local firms or local offices of national firms. My work frequently involved litigation support consulting and I have testified as an expert witness in both Federal and state courts.

In 1991 I was employed by the Property Tax Division of the Utah State Tax Commission as an analyst in the Centrally Assessed Utility Section performing annual appraisals of utility, transportation and communications property. In 1992 I was promoted to manager over that section and became responsible for the annual assessment of over 100 centrally assessed companies and the section's audit program. I was also heavily involved in settlement negotiation and the litigation of appeals. I have provided expert testimony regarding valuation, financial, economic or statistical issues numerous times, both in deposition and formal hearing, before the Utah State Tax Commission.

I joined the Division of Public Utilities at the first of January 2005 as a utility analyst and since then I have worked primarily in the energy section of the Division.

My resume is attached as DPU Exhibit 1.3.

Q: Please outline the projects you have worked on since coming to the Division.

A: I was involved in evaluating cost of capital issues in the most recent rate case with PacifiCorp; and I subsequently co-authored a paper regarding the Capital Asset Pricing Model (CAPM) to be published in the *Journal of Applied Regulation*. I have worked on DSM, service quality, and customer guarantees involving PacifiCorp. I am the Division lead on the forecasting task force, and have participated in other task forces. I am the Division lead on two internal research projects involving Ring-Fencing (now completed) and Fuel Issues for Electric Generation. The Ring-Fencing research project was done at the specific request of the Public Service Commission (PSC).

Most relevant for this matter is that since shortly after its announcement, I have been the lead of the economics and finance group within the Division assigned to evaluate the proposed acquisition (the Acquisition) of PacifiCorp (the "Company") by MidAmerican Energy Holdings Company ("MEHC").

Q: Have you previously provided testimony to the Commission?

A: Yes, I filed testimony in the recently concluded Uinta Basin Telephone case (Docket 05-053-01) regarding ring-fencing issues.

Q: Please outline the work and investigations that have been performed by the Division in this matter.

A: Beginning in June the Division has sent a series of data requests to PacifiCorp/MEHC. The Division has reviewed the responses to our data requests, to the data requests made by regulatory bodies in other states as well as the data requests by interveners in Utah and other states. PacifiCorp has provided to the Division copies of Scottish Power's or MEHC's answers to each of these data requests and the Division has reviewed these responses. Beginning with a June 29, 2005 meeting with MEHC, which was held before the Applicants formally filed with the Utah PSC, the Division along with the Committee of Consumer Services (the Committee) and interveners have met regularly and often with PacifiCorp and MEHC representatives in order to discuss issues and ask questions. The Division has also participated in conference calls with regulators in other states in order to better understand and identify issues of common interest. As deadlines set forth in the Commission's scheduling order approached the Division was able to obtain information from PacifiCorp on an expedited and often informal basis as well.

Q: Has PacifiCorp and MEHC been responsive to the Division's questions or requests?

A: Yes.

Q: Please summarize the areas the Division investigated in this matter.

A: Over the time period described above the Division has focused on areas regarding record keeping, access to records, and audit trails, ring-fencing, corporate presence and employee presence in Utah, and corporate overhead and other items that overall may provide a positive net benefit to ratepayers and the public generally. The Division also investigated other matters that arose during the process such as pension costs.

Q: Does the Division believe that all of the commitments made by PacifiCorp or MEHC in this matter are benefits attributable to the Acquisition itself?

A: The Division identified a number of items early on that did not appear to constitute new or additional benefits either to PacifiCorp or to ratepayers. A number of the commitments made by PacifiCorp and/or MEHC are for items the Division would expect from any prudently run utility. These include continuing an IRP process, and keeping regulators and interested parties informed about significant Company plans and actions.[1] PacifiCorp is already performing some of the commitments, e.g. filing an affiliate transaction report (Commitment 8); or that MEHC and PacifiCorp will obey the law (e.g. Commitment 7). A few commitments are difficult to evaluate because it would be difficult, if not impossible, to measure or observe any result (e.g. Commitment 21). Many commitments will require a prudence review for approval and implementation.[2] PacifiCorp/MEHC wanted these commitments left in as part of the Acquisition stipulation agreement. While the Division has no objection to leaving these commitments in as part of the acquisition agreement, the Division, however, considers them of secondary importance in evaluating the Acquisition.

Q: Aren't there any benefits associated with these commitments?

A: Of course there are some, mostly intangible, benefits; and none of these specific commitments are bad things to have. One benefit of having these commitments in writing is

[1] For examples of items the Division believes a prudent electricity company should follow, or other commitments to obey statutes, or existing regulations see Commitments 5, 19, 23, 24, 30, 31,33, 39, 41, 42, 44, 48, Utah 15, Utah 16, Utah 17, Utah 18, and Utah 19.

[2] Examples of Commitments requiring future prudence reviews and approvals are Commitments 34, 35, 36, 40, and 43.

that the Division, and other interested parties, can track PacifiCorp's follow-through and performance on these specific commitments. The Division believes, however, that the Acquisition itself does not necessarily contribute these benefits and therefore gives them less weight in the evaluation of the transaction.

Q: What has the Division considered in making an evaluation of the net benefits of this proposed transaction?

A: As discussed in more detail below, the Division has evaluated the proposed ring-fencing of PacifiCorp, the ability of the Division's auditors to audit any relevant books and records (both at PacifiCorp and at its parent companies and affiliates), and the protections afforded ratepayers from being charged for expenses associated with the Acquisition. Focusing on these items, the Division has evaluated the net positive benefits associated with the Acquisition.

Q: What has the Division concluded and what is it recommending?

A. Subject to the acceptance of the Stipulation and associated Commitments, the Division concludes that the proposed Acquisition provides net positive benefits and is in the public interest and should be approved.

II. LOCAL STAFFING

Q: Please describe the issue of local staffing.

A: There is a general belief by a number of parties that PacifiCorp needs to locate more personnel in Utah to better handle local needs. It is believed that too many positions are located in Portland, relative to the amount of business PacifiCorp does in Oregon compared to Utah.

Q: What has PacifiCorp or MEHC committed to with regard to local staffing?

A: General Commitment 47, and Utah-specific Commitments 5 and 6 are related to local staffing. Utah Commitment 8 promises an annual follow-up with senior Company management regarding the progress in implementing these commitments. While no definite plan is promised before September 2007, based upon representations and statements of representatives of PacifiCorp and MEHC, the Division's expectations from these Commitments are that staffing in Utah (and the other states as well) will be in commensurate to the actual size Utah represents to the PacifiCorp system. The Division recognizes that two or three years may be required for MEHC/PacifiCorp to plan and implement any necessary changes to fulfill these commitments, but good-faith progress is expected and will be monitored.

Q: What is the Division's position with respect to staffing?

A: The Division believes that Commitments and representations of PacifiCorp and MEHC represent a reasonable position on this matter.

Q: Do these Commitments on local staffing represent a net positive benefit to Utah ratepayers?

A: The actual plan will have to be reviewed before this question can be quantitatively evaluated. These Commitments do appear, however, to adequately respond—conceptually—to various parties' concerns.

Q: Does the Division believe that PacifiCorp/MEHC has adequately addressed this issue?

A: Yes. Consistent with the Division's desire to not substitute its judgment for that of PacifiCorp's management, PacifiCorp has proposed bringing and keeping staffing levels commensurate to the amount of business done in its Utah territory. This is a practical goal for meeting this issue. PacifiCorp will have a specific plan in place no later than 2007 and the Division and other interested parties will monitor the Company's progress.

III. CORPORATE PRESENCE/EXECUTIVE DECISION-MAKING

Q: Please discuss the corporate presence issue.

A: There are two parts to this issue. One is that there are those who believe that PacifiCorp should move its corporate headquarters to Utah, together with the majority of its senior executive management. Basically, the proponents of this position argue that the reason PacifiCorp should make such a move is that the portion of PacifiCorp's business in Utah is now greater than in any other individual state. While this may be a valid reason for moving a corporate headquarters, the Division believes that it is unrealistic and unreasonable to make such a move a condition of the Acquisition approval. PacifiCorp and its management would expend considerable time and expense in making the move with no guarantee that the move in and of itself would generally benefit Utahns.

The second aspect of this issue is the presence of executives in Utah who can be contact points for and make decisions, or get decisions made, regarding issues related to customers in Utah. In the past there has been frustration expressed, particularly by industrial customers, regarding apparent delays in decision-making by PacifiCorp. The perception has been that sometimes someone in Portland would have to be contacted as the primary contact point in the Company, and that the geographical distance impeded the flow of information, and sometimes, affected the priority assigned to resolving the problem or issue. The Division believes that this aspect of corporate presence could be addressed by PacifiCorp/MEHC with relatively little effort and expense by either increasing senior management presence in Utah or, at a minimum, delegating additional authority to existing management in Utah.

Q: What has been committed to in this regard?

A: Related to this issue PacifiCorp/MEHC has made staffing commitments discussed previously. But more specifically, MEHC/PacifiCorp has committed to have senior management personnel located in Utah who will be authorized to make decisions pertaining to local tariff interpretations, line extensions, service additions, and "customer service matters related to adequate investment in and maintenance of the Utah sub-transmission and distribution network and outage response." [3] MEHC has promised that for other items and issues there will be negotiations and contacts with local personnel with prompt corporate and board approval procedures as necessary.[4]

Q: Has PacifiCorp/MEHC's commitment satisfied the Division?

A: Yes. The commitment is specific enough that the Division believes that meaningful improvement should result from this commitment. The Division will be able to monitor the success of this commitment through its specific implementation and through future customer experience reported to the Division. Fulfillment of this Commitment is expected to result in a net positive benefit to Utah ratepayers.

<u>IV. AUDIT ISSUES</u>

Q: What audit issues arise with respect to this proposed Acquisition?

A: The audit issues are broad and general. The audit issues revolve around the Division's ability to monitor and document the Acquisition commitments and to generally conduct its mandate

[3] Utah Commitment 7.
[4] See Utah Commitments 7 and 8.

to regulate the utility including the effects of the parent holding company (specifically MEHC) on the operations of PacifiCorp. Generally the Division is satisfied that it will be able to continue to adequately audit and investigate the activities of PacifiCorp and the related activities of its parent and affiliates. Division witness Carolyn Roll is providing testimony specific to this issue and I defer to her testimony for a detailed discussion of auditing and accounting-related issues.

V. SERVICE QUALITY AND CUSTOMER GUARANTEES

Q. What post-Acquisition protections do customers have relative to the quality of service offered by PacifiCorp?

A: PacifiCorp and MEHC have necessarily committed to continue the customer guarantees found in Utah Power & Light Company's Utah Electric Service Regulation No. 25. This year PacifiCorp requested, and earlier this year received, approval to modify its customer guarantees (Docket No. 01-035-T13). The customer guarantees will continue after the Acquisition because they are part of an actual tariff approved by the Commission and would require Commission approval to be modified or eliminated.

In the same docket, PacifiCorp requested and the Commission approved several modifications to the Service Quality or Performance measures, specifically, the definition of a "major event" was changed to adopt the IEEE definition. The Commission acknowledged extension of the performance standards to 2008 in a letter dated April 29, 2005.

Q: Are there material changes to the performance standards penalties since the Scottish-Power/PacifCorp merger?

A: Yes. The one-dollar per customer penalty for failure to satisfactorily meet the performance standards expired after five years and is no longer in force. Any penalties that would apply would be the general penalty for failure to comply with a Commission order.

Q: Was this one-dollar penalty ever applied?

A: No. PacifiCorp has successfully met the applicable performance standards to date.

Q: Are there additional performance commitments being made by PacifiCorp/MEHC as part of the Acquisition?

A: Yes. Commitments 1, 2, 45, Utah 1, Utah 8, and Utah 9 offer to extend the performance standards out to 2011, with the possibility of modifying them after 2008 as the parties agree is appropriate. The Division, the Company, and interested parties are continuing to meet in the previously established Service Quality Task Force and may make further recommendations to the Commission. Specifically, the issue of reinstituting specific penalties for failure to meet performance standards or incentives for meeting or exceeding these standards is being examined in this Task Force, and a recommendation on penalties may be forwarded to the Commission.

Q: Is the Division satisfied that there are sufficient performance standards and customer guarantees in place that the public interest is protected with respect to the proposed Acquisition?

A: Yes, for the near term. While some changes or modifications were discussed during settlement conferences, the Division believes that without further analysis specific recommendations at this point would be premature. As indicated above, the Service Quality Task Force is studying service quality issues and may recommend additional standards or other changes in the future.

VI GENERATION AND TRANSMISSION ISSUES

Q: What commitments has PacifiCorp/MEHC made with respect to generation and transmission?

A: Generation and transmission-related issues, including Demand-Side Management programs, are covered in Commitments 34 to 36, 39 to 44 and Utah Commitments 15 to 18.

Q: These commitments were identified earlier as not being Acquisition-specific commitments. Do you have further comments about them?

A: The Division generally believes that the commitments PacifiCorp/MEHC has made with regard to generation and transmission are appropriate ideas that a prudent electric utility operating in Utah should be considering. The Division believes that the next step is to include specific proposals in the Company's Integrated Resource Plan, and ultimately in a SB 26 proceeding for approval, if a specific project can be shown to be prudent and in the public interest. While the Division supports the on-going or future consideration of the various items mentioned, in this docket the Division is not taking a position or otherwise rendering an opinion that any one of the identified projects is prudent and in the public interest.

VII FEDERAL AND STATE REGULATION

Q: What regulatory issues are raised with respect to this proposed Acquisition?

A: The primary issue is the continued ability of the PSC to adequately regulate PacifiCorp to protect the public interest.

Q: Does the Division believe that the Commission will continue to be able to do so?

A: Yes. Specific commitments by MEHC and PacifiCorp indicate MEHC's and PacifiCorp's continuing recognition of the PSC's authority.[5] As a matter of course PacifiCorp still will have to obey state laws and regulations as it does now. MEHC has committed to making available for audit documents and other information that are relevant to PacifiCorp.

Q: How will the repeal of PUHCA affect the regulatory environment?

A: A principal effect of the PUHCA repeal[6] is that there will be much reduced federal oversight of parent holding companies with respect to their management of their regulated utility holding companies. Specifically, the Securities and Exchange Commission (SEC) will cease to pursue all PUHCA-related activities. Some of the SEC's activities will be transferred to FERC, but it is unclear and uncertain at this point how FERC will implement its new authority. FERC is supposed to issue rules on December 8, 2005.

The ability of a parent holding company to act to the detriment of its regulated utility is reduced by having the utility ring-fenced (ring-fencing is discussed further below). An aim of PUHCA was to prevent a holding company from exercising its authority over the utility such that it harmed the utility or its customers. Ring-fencing reduces the risk of the parent holding company harming the utility. State regulators can monitor and enforce the ring-fencing provisions to prevent harm to the Company or its customers.

Q: There is an action filed by PacifiCorp in federal court arising out of a Wyoming regulatory matter. How does this action affect the proposed Acquisition?

A: The Wyoming matter refers to the ability of state regulators to review the prudence of certain wholesale transactions by the Company, and the Company's ability to seek redress in the

[5] Commitments that are generally related to the Commission's ability to regulate PacifiCorp include Commitments 10, 12, 17, 18, 49, Utah 2 through 4, Utah 10, Utah 12 through 14, Utah 21 and Utah 28. A number of these Commitments fall into other categories discussed here as well.

[6] The repeal of PUHCA will go into effect on February 8, 2006.

federal court system after the state supreme court has ruled. This situation in Wyoming was on-going prior to announcement of the Acquisition. Intervener parties raised this issue with PacifiCorp/MEHC in the course of settlement discussions on the proposed Acquisition. Utah Commitment 27 has been included by PacifiCorp/MEHC to deal with this issue. The language in the commitment was agreed upon by the parties as a proper acquisition commitment dealing with this issue.

Q: Overall, then, what do you conclude about the federal and state regulatory issues related to the acquisition?

A: The authority of the Commission will be maintained subsequent to the Acquisition. There are, however, some uncertainties which would prevail with or without this proposed Acquisition. What the post-PUHCA world will be like is a work in progress. However, many of the post-PUHCA issues are potentially solved with the strong ring-fencing commitments that can be enforced by state regulators. The Wyoming federal case may be resolved after the Acquisition occurs.

Q: Are there other regulatory issues that should be dealt with in connection with this proposed Acquisition?

A: Yes. Another issue has to do with affiliate transactions and other relationships. From a utility customer point of view, the ideal situation is for the utility to get the benefits, i.e., reduced costs that may be available from the utility being part of a larger organization. These benefits include items such as more efficient and cost-effective purchasing power; obtaining a better credit rating through affiliation with a strong parent, while avoiding any potential downsides such as receiving a lower credit rating because of the parent; or purchasing goods and services from affiliates at above-market prices. Regulators need to decide what benefits they want and what risks they are willing to tolerate to get those benefits. For example, the desirable ability to improve purchasing power may be only available at the risk of allowing the possibility of self-serving transactions with the parent or affiliates that are not in the customer's interest. These issues are dealt with further in the Division's witness, Carolyn Roll's testimony and also in the ring-fencing section below.

VIII. COMMUNITY ISSUES

Q: What general community issues have been raised with respect to the proposed Acquisition?

A: The Company has committed to continue community programs as set forth in their Acquisition Commitments 26, 27, 46, Utah Commitments 24 through 26.

Q: These are included in your list of commitments that the Division believes are of secondary importance. Are there additional comments you want to make?

A: Yes. Most of these commitments are not funded as part of the Company's regulated revenue requirement. However, these issues are of interest and helpful to certain ratepayers. The Division supports any voluntary use of stockholder money to benefit the community.

IX. RING-FENCING

Q: Earlier you indicated the need for ring-fencing to help protect rate payers due to a lessening of federal oversight of parent companies of regulated utilities. What is ring-fencing?

A: In this context ring-fencing can be defined as structural and operational practices and concepts imposed on a utility operating company, such that the utility operating company is insulated from the operations and financial results of affiliates or a parent holding company. That is, the utility can be said to be "fenced-off" from unregulated or other regulated businesses of the parent company. Usually ring-fencing procedures and practices are put in place to protect the utility and its customers from bearing any burdens resulting from financial or other distress in affiliates or a parent company. Of key concern to regulators is often the protection of the utility's credit standing in the market place, but other issues, including going-concern/bankruptcy and affiliate transaction issues may be among the reasons for ring-fencing.

Q: Is PacifiCorp going to be ring-fenced after this transaction?

A: Yes. The Applicant's filing in this matter originally stated the intention to ring-fence PacifiCorp in part to protect its credit rating.[7] Several of the Commitments attached to the Stipulation among the parties implement a number of ring-fencing procedures. Exhibit 1.1 provides a list of the Commitments that are related to ring-fencing.

Q: Are these ring-fencing procedures among the "best practices"? What are some of the principal ring-fencing procedures and practices?

A: The following is a list of "best practices" that can be gleaned from Standard & Poor's and Fitch rating services. These "best practices" are not exhaustive of the items that could be included by regulators for their purposes in a ring-fence, such as extending conditions on transactions with affiliates.[8]

1. The regulated utility is a corporate subsidiary in a holding structure.
2. The regulated utility is placed in a Special Purpose Entity, which is legally separate from the non-regulated affiliates of the parent.

[7] Direct Testimony of Patrick J. Goodman, pp. 16-17.
[8] Peterson, Charles E., and Elizabeth M. Brereton, *Report on Ring-Fencing*, Utah Division of Public Utilities, September 2005, pp. 19-21.

3. The provision of so-called "nonpetition" (bankruptcy) language by the parent.
4. The utility is managed separately and has a separate board of directors.
5. The utility's books and records are kept separate from any affiliates.
6. The utility has its own bank accounts and credit facilities, its own separate debt and has its own separate credit rating.
7. Limits imposed on capital structure, e.g. setting a minimum common equity percentage in the capital structure.
8. Limits on inter-company guarantees and loans—including loans to money pools.
9. Limits on dividends.
10. A written Affiliate Code of Conduct is in place.
11. Finally, violations of these practices are supported by clear penalties from regulatory authorities.

A paper prepared by NARUC's Subcommittee on Accounting and Finance outlined five areas of possible ring-fencing measures:[9]

1. Commission authority to restrict and mandate use and terms of sale of utility assets. This includes restriction against using utility assets as collateral or guarantee for any non-utility business.
2. Commission authority to restrict dividend payments to a parent company in order to maintain financial viability of the utility. This may include, but is not limited to, maintenance of a minimum equity balance.
3. Commission authority to authorize loans, loan guarantees, engagement in money pools and large supply contracts between the utility and affiliate companies.

[9] Ibid.

4. Commission authority over establishment of a holding company structure involving a regulated utility.
5. Expand commission authority over security applications to include the ability to restrict type and use of financing.

Q: Does the post-Acquisition ring-fencing of PacifiCorp comply with these "best practices"?

A: Yes. All of the common stock of PacifiCorp will be owned by PPW Holdings LLC (PPW). The sole member of PPW is MEHC. PPW's sole purpose will be to hold the common stock of PacifiCorp and will "have an independent director from whom assent is required to place [PPW] or PacifiCorp into bankruptcy; require PacifiCorp to maintain separate books, financial records and employees, and will prohibit the commingling of assets; have a non-recourse structure which precludes liabilities of MEHC, or its subsidiaries, from being assessed against [PPW] or PacifiCorp; prohibit [PPW's] or PacifiCorp's credit from being made available to satisfy obligations of, or to be pledged for the benefit of, any other company; prohibit [PPW] or PacifiCorp from acquiring the obligations or securities of MEHC or any of its other affiliates except, of course, that PacifiCorp may purchase its own obligations; and require the consent of the independent director, and rating agency confirmation, that there will be no credit downgrade for any amendment to the above mentioned protections."[10]

These commitments regarding the immediate parent of PacifiCorp, PPW, satisfy the "best practices" of the credit rating agencies numbers 1 through 6 and 8. Capital structure

[10] Goodman, Patrick J., *Direct Testimony of Patrick J. Goodman.* Testimony filed with the Public Service Commission of Utah, July 2005, Docket No. 05-035-54, pp. 16-17.

restrictions are specifically covered in Commitment 18 and implicitly in commitments on restricting debt issuance, e.g. Commitment 20. The proposed IASA discussed in Division witness Carolyn Roll's testimony along with PacifiCorp's current procurement policy appear to satisfy the expectation of a written code of conduct governing affiliate transactions (best practices number 10). Exhibit 1.2 compares the "best practices" lists with the Commitments attached to the stipulation, or with statutory authority of the Commission. As can be seen on Exhibit 1.2, all of the listed "best practices" are covered either by the testimony regarding the structure of PPW, the Commitments, or by the Commission's statutory authority, or a combination of these items.

Q: Is it your testimony that following the Acquisition, PacifiCorp is expected to be adequately ring-fenced to protect the Company and the public interest?

A: Yes.

Q: Are there possible detriments to a successful ring-fencing of the regulated utilities?

A: Yes. A tight ring-fence could eliminate subsidies or prevent other benefits from flowing to PacifiCorp from other affiliates of MEHC or Berkshire Hathaway. Such items could include the lower cost of debt, discussed below, that PacifiCorp is expected to receive from its association with Berkshire Hathaway. PacifiCorp may find that it is not able to participate in economies of scale that the total parent holding company, and non-ring-fenced affiliates, might enjoy resulting from larger purchases; or in having company-wide services such as human resources, legal, and accounting. One example of the purchasing power that might be affected by ring-fencing would be that PacifiCorp and its prospective affiliate, MidAmerican Energy Company (MEC), which is the electric and gas utility operating primarily in Iowa, are prevented from benefiting from joint purchases of coal and railroad or other transportation services.

Q: Could a middle ground be obtained where the benefits of ring-fencing could be enjoyed, but loss of some of the economies you mention could be mitigated?

A: Yes. For example, the parent holding company or a subsidiary might provide "staff" functions such as human resources, legal, and accounting and possibly financing and purchasing, but detailed accounting processes need to be in place and regulators may need to closely follow the transactions.

X. BENEFITS

Q: What types of benefits are expected to result from this transaction?

A: The benefits can be roughly divided into two types: "intangible" benefits and "tangible" benefits. "Intangible" benefits are benefits for which a definite economic dollar amount cannot be applied. "Intangible" does not necessarily mean that the benefit cannot be observed, but it may be simply that the Company performs or it does not perform on a commitment. Conversely, "tangible" benefits are those benefits in which an economic dollar amount may be assigned.

Q: Please describe the "intangible" benefits that the Division has identified in the Stipulation and attached Commitments.

A: As discussed above, there are commitments that the Division believes should be performed by any prudent electric utility. These mostly have to do with promises to study various transmission and generation possibilities. There is minimal benefit to these promises resulting from the Acquisition *per se*. But we do have the commitments in writing and the Division and other interested parties can follow-up on these commitments.

Other Commitments discussed above add little, since they are either immeasurable or simply commit the Company to abiding by statutes and regulations. Some promise that PacifiCorp will continue to do what it already does.

Some Commitments, however, are beneficial but a specific dollar amount cannot be applied. The Division believes that the following commitments have a net positive benefit, although a dollar amount cannot be calculated:

- Ring-fencing. The strict ring-fencing procedures proposed for PacifiCorp are generally considered desirable by both regulators and debt rating agencies. PacifiCorp is already ring-fenced to some degree. (The current ring-fencing is not complete as evidenced by PacifiCorp's debt rating remaining tied to Scottish Power.[11]) However, the proposed Acquisition has given the Division and other state bodies and interveners the opportunity to investigate the ring-fencing in the proposed Acquisition to insure that the important points and procedures will be in place.
- Executive decision-making. Utah Commitment 7 is anticipated to improve the responsiveness of the Company to customer needs and mitigate previous complaints.

[11] For example see Standard & Poor's *Credit FAQ: PacifiCorp's Rate Case Ruling*, 07-Oct-05.

- Local Staffing. Commitments on local staffing appear to be a net gain for Utah. However, an actual benefit-cost analysis won't be possible until after the staffing plan is promulgated on or before September 1, 2007. At that time an actual economic analysis could be performed. In the meantime, the Division and other interested parties can monitor PacifiCorp's actions to assure themselves that Utah is not becoming worse off.
- Performance Standards. MEHC/PacifiCorp's commitments to extend the performance standards and, specifically, to not seek to end or modify the standards without Commission approval is a net gain over the existing situation. At the present time PacifiCorp may unilaterally end the current performance standards. Customer guarantees, which are often lumped with performance standards, are part of a tariff and not subject to change without Commission approval.
- "Most favored nation," Utah Commitment 27. Utah will get the benefit of any additional commitments MEHC/PacifiCorp negotiate with other states that are viewed to be favorable to Utah. This protects Utah from any disadvantage of being the first state with a major service territory for PacifiCorp to settle in this matter.

Q: Are there other "intangible" benefits that result from this proposed Acquisition that have been identified?

A: Yes. Perhaps the most significant one is the simply fact that MEHC wants to own PacifiCorp, whereas, PacifiCorp no longer meets Scottish Power's corporate strategy. The reason given for Scottish Power's desire to dispose of PacifiCorp relates to the high level of capital expenditures required over the next few years that Scottish Power doesn't want to fund.[12] The Division believes that, everything else being equal, PacifiCorp, its employees and customers, are better off with an owner interested in investing in and promoting the Company for the long term, rather than one that is looking to sell.

There are other minor changes that are expected to result from the Acquisition that should result in positive benefits. Among these include MEHC's intention to have PacifiCorp convert its fiscal year end to match the calendar year. This will be more convenient because, for example, calendar year-end audited data will match the regulatory year-ends and the year-ends of other companies in the industry with which comparisons might be made.

Q: One claimed benefit that might be called an "intangible" benefit is that MEHC is a privately-held long-term investor that can be patient with developing PacifiCorp's value over a long-term period and not overly concerned with quarterly results.[13] Do you have any thoughts on this claim?

A: This prospective benefit is connected to the above-mentioned benefit of gaining an owner that wants PacifiCorp. It is true that the managements of publicly-traded companies have been criticized for focusing on short-term earnings and not on the long-term profitability of their companies. To the extent the claimed concern for the long-term by MEHC turns out to be true, then there is probably a benefit to PacifiCorp and ratepayers because of this. Ultimately, though, MEHC is controlled by a public company and in the future the public parent company may begin to pressure MEHC for current dividends and other short-term

[12] Direct Testimony of Judi A. Johansen, pp 8-9
[13] See Direct Testimony of Gregory E. Abel, pp. 10-12.

benefits. Similarly, at a future time the owners of a private corporation could decide to make similar demands. In sum, given MEHC's testimony, this is likely a net benefit due to the Acquisition, but the Division doesn't put much weight on it in considering the appropriateness of the transaction.

Q: What "tangible" benefits are expected to result from this transaction?

A: There are two benefits identified from this Acquisition that can be quantified in dollar terms. The first benefit is the reduction in net corporate overhead expense paid by PacifiCorp. The second benefit is the promised reduction in cost of debt.

Q: Please describe the benefit from the corporate overhead reduction.

A: Forecast figures from Scottish Power indicate that PacifiCorp's apparently allowable corporate overhead charge will be about $15.7 million. This is up from the approximately $10.7 million that was allowed by Division auditors in the last PacifiCorp rate case (Docket No. 04-035-42). The $15.7 million and the $10.7 million are supposed to be comparable in that they both contain the same line items, and exclude the items that were disallowed by Division auditors. MEHC is proposing to cap the corporate overhead expense charged PacifiCorp at $9.0 million for five years.[14] As detailed in Division witness Carolyn Roll's testimony, this could result in a savings for ratepayers, system-wide, of up to $30 million over the five years based upon a current exchange rate of about 1.7 dollars to the pound sterling.[15] If, following an audit, the Scottish Power net corporate expense were reduced to an amount similar to the last rate case, say, to $11 million, then the $2 million differential

[14] See Commitment 38.

[15] In arriving at the $15.7 million figure, the overhead charge to Scottish Power was calculated in pounds sterling and converted to dollars using an exchange rate of 1.8 times. Using the more recent exchange rate of approximately 1.7 times, the overhead charge in dollars drops to about $14.8 million. Thus the differential between $9.0 million and $14.8 million is $5.8 million, which carried out over five years amounts to $29 million. Since any actual amount over five years is subject to a number of assumptions, the rounded $30 million amount is used as an upper limit.

would benefit rate payers, system-wide, by a total of $10 million. In considering this Acquisition, the Division has valued this benefit using the $10 to $30 million range.[16]

Q: Please discuss the benefit resulting from a lower cost of debt.

A: MEHC proposes that due to association with Berkshire Hathaway, PacifiCorp should experience a slightly reduced cost of debt of 10 basis points.[17] MEHC projects a savings to PacifiCorp that would be available to ratepayers, system-wide, of $6.3 million over five years and up to $26 million over ten years.[18] MEHC is guaranteeing that it, or PacifiCorp, can demonstrate the 10 basis point savings over five years, or automatically face a reduction of 10 basis points for rate-making in newly issued debt by PacifiCorp.

Q: In their Utah Commitment 23 MEHC/PacifiCorp agree to postpone the implementation of new rates from the next rate case by at least 45 days; doesn't this constitute a quantifiable benefit?

A: It may constitute a net positive benefit, but it would be difficult to quantify. The reason is that the results of the prospective rate case in 2006, based upon a forecast test year, cannot be estimated at this time with any precision. Further, there are possibly future costs and consequences in rate cases after 2006. The net present value these future costs and consequences may mitigate the benefit immediately gained by delaying the effective date of the any new rates in 2006. However, in general, the Division believes that this commitment represents a positive benefit to Utah ratepayers.

---

[16] In arriving at these calculations, the Division has not included the possibility that part of MEHC's proposed may be disallowed for ratemaking. If a portion is eventually disallowed, then the benefits would be proportionately higher.

[17] See Commitment 37. Also refer to the Direct Testimony of Patrick J. Goodman, pp 8-9.

[18] Direct Testimony of Patrick J. Goodman, p. 9.

Q: There was an issue raised in Oregon that the corporate overhead charge was not only not as much as MEHC claimed, but that it was actually negative, that is, that ratepayers were going to be worse off. What is the Division's position on that claim?

A: The Division believes that this claim in Oregon was preliminary and in error. The initial claim assumed that the $15.7 million figure was before a reduction of $2.9 million in charges to Scottish Power by PacifiCorp, and excluded consideration of $7.3 million in PacifiCorp staff expenses that went to support the non-regulated affiliates that would, post Acquisition, become a burden to ratepayers. Information provided by PacifiCorp to the Division indicated that the $15.7 million was net of the $2.9 million charged by PacifiCorp to Scottish Power, so that the Acquisition wouldn't be a detriment because of this loss of revenue. Further, the majority of the $7.3 million in expenses were for employees dedicated to servicing the non-regulated affiliates who, along with their salaries, will be transferred to the non-regulated affiliates at the time the transaction closes. The remaining amount of the $7.3 million will be eliminated in a year or two following the closing of the acquisition as post acquisition adjustments are made. The Division concludes that this is a non-issue.

Q: MEHC has committed to expend up to $1 million in stockholder's money for a system-wide demand-side management (DSM) study.[19] Why haven't you discussed that as a measurable benefit?

A: The expenditure of $1 million for a DSM study may be duplicative of studies that have already been done over the past few years. Until the Division has a better understanding of what exactly will be studied, there is no assurance that such a study will result in an incremental benefit to ratepayers. Therefore, at this time the Division does not include this proposed study as necessarily a positive benefit to Utah ratepayers. Of course, the Division

[19] See Commitment 44.

recognizes that a properly constructed study could potentially identify additional cost-effect DSM projects. If this turns out to be the case, then this is a positive benefit to ratepayers arising from the Acquisition.

Q: The testimony above considered system-wide benefits to ratepayers. What are the quantifiable benefits accruing specifically to Utah ratepayers?

A: The total quantifiable benefits amount to $16 million to $36 million over five years, or about $3 million to $7 million per year. Assuming that Utah makes up about 40 percent of the total system, then the Utah benefits amount to approximately $1 million to $3 million per year over the next five years.

Q: Frankly, these are not a lot of quantifiable benefits, are they?

A: No, they are not. MEHC has never claimed that its ownership would bring tremendous monetary benefits to PacifiCorp ratepayers. Indeed, MEHC has emphasized that PacifiCorp, post Acquisition, will continue to operate much as it has before, with, perhaps, relatively slow change to the “MEHC way.” Beyond the modest benefits delineated above including “intangible” benefits: what may be the most significant advantage of allowing the Acquisition to proceed is also mentioned above: Scottish Power wants to sell PacifiCorp and MEHC is a competent, willing buyer. In the short-run, at least, PacifiCorp, and its customers, could be worse off than they are now should the Acquisition fall through, given that PacifiCorp would continue to not be part of Scottish Power’s strategic plans.

XI. COSTS

Q: Please outline the costs associated with this Acquisition.

A: There are a number of costs associated with this Acquisition that are expected to be borne by the stockholders of PacifiCorp, Scottish Power, and MEHC. These costs include the acquisition premium that MEHC will pay Scottish Power when the Acquisition closes, the costs incurred in seeking approval of the Acquisition, and any post-Acquisition costs associated with the transaction such as retention bonuses or other benefits that might be paid to keep top PacifiCorp executives or other key employees. MEHC and PacifiCorp have committed that these are stockholder-paid expenses through Commitments 16, 22, Utah 4, and Utah 22. Additionally, as discussed under **VIII Community Issues** above, funds expended for Commitments Utah 24 to Utah 26 will come out of stockholder funds.

Q: Could there be other costs, presently unforeseen, that ratepayers may end up paying for that are connected to the Acquisition?

A: Of course, as a theoretical possibility. However, if the costs can be associated with the transaction, MEHC and PacifiCorp have committed to excluding them from rates.

Q: Earlier you discussed "intangible" benefits, aren't there, at least potentially, "intangible" costs?

A: There is always a risk that a new owner will fail to perform as well as a previous owner; that is, MEHC may take over and make a mess of things that ratepayers will ultimately pay for either in higher rates, or lousy service, or both. While this risk is a theoretical possibility, there is no indication that it is a likelihood given that MEHC has successfully managed acquisitions in the past and currently appears to be successfully managing other regulated businesses.

Q: Isn't Warren Buffett potentially an "intangible" cost?

A: While Mr. Buffett is a singular individual on the American business landscape as a near-legendary investor and businessman, the Division believes that his presence “behind” MEHC is little different than the presence of any other large stockholder, either as an individual or another large corporation. Any risks to PacifiCorp and ratepayers that may be attributed to Mr. Buffett could just as well be attributed to any other major investor or large corporate presence. The Division believes concerns about Mr. Buffett in particular are unwarranted.

Q: But couldn’t your generic investor or “large corporation” do damage to PacifiCorp and ultimately ratepayers?

A: Again, of course. However there are protections in place to mitigate any such possibility. The Commission will be able to regulate PacifiCorp as it has always done. Beyond the Commission’s inherent authority, ring-fencing mechanisms are expected to be put in place that the Division believes will make it difficult for a parent company, or an investor, to take actions significantly detrimental to PacifiCorp and to the public interest.

Q: Utah Commitment 16 appears to contemplate additional costs that ratepayers may bear with respect to implementing an IGCC coal plant option in the 2012-2014 time frame. Isn’t this an Acquisition cost that should be considered?

A: No. While this is part of the Commitments included with the Stipulation, it is not a cost resulting from the Acquisition. The Division and other parties are interested in having an IGCC (Integrated Gasification Combined Cycle) coal plant option as soon as possible. This technology is only now becoming available and vendors won’t make commitments to build and operate such plants without requisite studies being performed. PacifiCorp/MEHC agreed to participate in these studies if cost recovery would be available. These costs, if expended, are really a separate issue from the Acquisition itself. The Acquisition settlement discussions became a convenient forum to discuss and reach some agreements regarding the IGCC issues.

XII. RECOMMENDATIONS

Q: What conclusions have you reached?

A: The Division concludes that the benefits of the Acquisition outweigh the costs. Thus, the Acquisition satisfies the positive net benefits test.

Q: What are your recommendations in this matter?

A: Given the foregoing discussion the Division recommends that the Utah Public Service Commission approve the stipulation as signed by the parties and consequently approve the Acquisition of PacifiCorp by MidAmerican Energy Holdings Company as beneficial and in the public interest.

Q: Does this complete your testimony?

A: Yes.