Witness CCS – 1DTY
Exhibit CCS – 1DTY

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application	**)**	**DOCKET NO. 06-035-21**
Of PacifiCorp for Approval of	**)**	**PRE-FILED DIRECT TEST YEAR**
Its Proposed Electric Service	**)**	**TESTIMONY OF**
Schedules and Electric	**)**	**DONNA DERONNE**
Service Regulations	**)**	**FOR THE COMMITTEE OF**
	)	**CONSUMER SERVICES**

June 9, 2006

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INTRODUCTION

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. My name is Donna DeRonne. I am a Certified Public Accountant licensed in the State of Michigan and a senior regulatory analyst at Larkin & Associates, PLLC, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES, PLLC.

A. Larkin & Associates, PLLC, is a Certified Public Accounting Firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin & Associates, PLLC has extensive experience in the utility regulatory field as expert witnesses in over 600 regulatory proceedings, including numerous electric, water and wastewater, gas and telephone utility cases.

Q. HAVE YOU PREPARED AN EXHIBIT DESCRIBING YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Appendix I, which is a summary of my regulatory experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Larkin & Associates, PLLC, was retained by the Utah Committee of Consumer Services (Committee) to review PacifiCorp's (the Company) application for an increase in rates in the State of Utah. Accordingly, I am appearing on behalf of the Committee.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony addresses: (1) the test year alternatives that the Commission can select from as set forth by recent changes in the statutory provision addressing test year; (2) the advantages and disadvantages of test year alternatives; (3) the appropriate test year to be used in this rate case; and (4) safeguards that could be used to protect ratepayers should the Company substantially modify its projected capital and expense budgets after new rates are approved and implemented or should actual results differ substantially from what has been presented in this case.

SUMMARY AND RECOMMENDATION

Q. **WHAT TEST YEAR DOES THE COMMITTEE RECOMMEND BE USED FOR THIS RATE CASE?**

A. Based on the unique facts and circumstances inherent in this rate case, the Committee supports the use of the Company's proposed future test year ending September 30, 2007. However, our support of the

Company's proposed test year is contingent upon safeguards being put into place that would make PacifiCorp more accountable for its projections and provide more assurance that the costs it forecasts are consistent with what actually occurs in the rate effective period. Specifically, the Committee has concerns about the accuracy and reliability of forecasted information pertaining to various capital investment and expense items going out twenty months into the future; and those concerns are further magnified in this instance by the fact that PacifiCorp was only recently acquired by MidAmerican Energy Holdings Company (MEHC). These concerns are described more fully in later sections of my testimony.

<u>TEST YEAR ALTERNATIVES</u>

Q. WHAT TEST YEARS WERE PRESENTED BY PACIFICORP IN ITS FILING?

A. Consistent with previous agreements among the parties, PacifiCorp provided its adjusted Results of Operations in this case for three separate periods. The first period consists of the historical twelve months ending September 30, 2005 with normalizing adjustments, which is the "Base Period." The second period is the "Mid Period", which is the twelve months ending September 30, 2006. The third period presented is the projected twelve months ending September 30, 2007, which is the test year requested by PacifiCorp in this case.

Q. WHEN ADDRESSING THE SELECTION OF THE TEST YEAR, PACIFICORP WITNESS JEFFREY K. LARSEN INDICATES THAT "THE COMMISSION'S STATUTORY CHARGE IS TO SELECT THE TEST PERIOD THAT, IN THE EXERCISE OF ITS JUDGMENT BASED ON THE EVIDENCE, WILL BEST REFLECT THE CONDITIONS IN THE RATE EFFECTIVE PERIOD." IS THIS AN ACCURATE SUMMARIZATION OF THE STATUTORY CHARGE?

A. Yes. Section 54-4-4(3) of the Utah Statutes specifically 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.

Q. DO THE UTAH STATUTES SPECIFICALLY REQUIRE THAT A FUTURE TEST YEAR BE USED?

A. No, they do not. In addressing the establishment of the test year, the Utah Statutes in Section 54-4-4(3), specifically state:

> (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 rate increase or decrease is filed with the commission under Section 54-07-12;
> >
> > (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.

According to the statutory language, the Commission can select from three basic test year options. These options include a historical test year adjusted for known and measurable changes, a future test year for which the end date does not exceed 20 months from the date the case is filed, and a mixed test year that is a combination of historical information and future projections. While the future test year may not exceed 20 months from the date the case is filed, it may consist of almost any twelve month period prior to that 20 month limitation. A mixed test year also results in many test year options.

In selecting the appropriate test year, therefore, the key criteria for the Commission is that the test year, based on the evidence presented, needs to reflect the conditions that will be encountered by a utility during the rate effective period. Depending on the facts and circumstances of a specific case, a historical test year with known and measurable adjustments may be superior to a future test year. Stated differently, there is no presumption in the statutory language automatically favoring the use of a future test year.

Q. IN YOUR OPINION, CAN THE USE OF A HISTORICAL TEST YEAR WITH KNOWN AND MEASURABLE CHANGES RESULT IN RATES THAT BEST REFLECT THE CONDITIONS THAT WILL BE ENCOUNTERED BY A UTILITY DURING THE RATE EFFECTIVE PERIOD?

A. Yes. If the overall relationship of investment, revenue and expense are expected to remain consistent into the rate effective period, then a historical test year with known and measurable changes can result in new rates that afford a utility a reasonable opportunity to recover its costs and earn its authorized rate of return.[1]

Q. IS THERE A TERM COMMONLY USED WHEN ADDRESSING THE NEED TO MAINTAIN A CONSISTENT RELATIONSHIP BETWEEN INVESTMENT, REVENUE AND EXPENSE IN A TEST YEAR?

A. Yes. This has been traditionally referred to as the “matching principle.”

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[1] Likewise, a mixed test year, based on both actual and projected numbers, can also produce rates that reflect expected conditions in the rate effective period.

Q. PLEASE BRIEFLY DESCRIBE THE MATCHING PRINCIPLE.

A. Changes in ratemaking components will inevitably occur over time. Investment (rate base) will increase as new plant is added to serve new customers and decrease as plant is depreciated and retired. Revenues will increase as customers are added or usage per customer rises. Expense levels will fluctuate. Changes in investment, revenue and expense do not occur in isolation and need to be properly matched or synchronized within a test year. If the components are not properly matched, then a distortion of the relationship between the various ratemaking components will occur.

For example, when a new generation plant is included in rates as a known and measurable adjustment outside the historical period, there is not only an increase in rate base, but there are impacts associated with the addition of the new plant on (1) net power costs (normally lowers NPC expense) stemming from changes in the level of market purchases and economic dispatch of existing generation resources, (2) revenue (normally increases revenue) since the new generation plant is being included in rates to meet load growth, and (3) depreciation expense.

Q. ARE THERE SIGNIFICANT ADVANTAGES TO THE USE OF A TEST YEAR THAT IS LARGELY BASED ON HISTORICAL INFORMATION VERSUS A FULLY PROJECTED TEST YEAR?

A. Yes. The use of a historical test period with known and measurable adjustments allows for a detailed analysis of the actual investment, revenue and expense amounts recorded on the Company's books. This greatly aids in the evaluation process and leads to more certainty and less speculation in setting new cost-based rates. It also avoids potential negative consequences of analyzing a moving target, which can occur when a projected (or partially projected) test year is used. Again, if the overall relationship between investment, revenues and costs is consistent and anticipated to continue going forward, then a historical test year with known and measurable changes can produce rates that are reflective of future conditions.

Q. WHAT IS THE PRIMARY DISADVANTAGE OF USING A FUTURE TEST YEAR TO SET NEW RATES?

A. The greatest disadvantage relates to the accuracy and reliability of forecasted information. Additionally, all of the changes and events that may transpire in the period leading up to and during the future test year are not known. It may be difficult to determine the validity of the cost and revenue projections because the underlying information is within the Company's control and subject to change. Moving to a future test year shifts additional risk to customers because regulators are more reliant upon the Company providing accurate and up-to-date information regarding capital budgets, O&M/A&G expense budgets, revenue forecasts, etc., as opposed to relying on actual, historical data.

Q. CAN YOU CITE ANY EXAMPLES OF ITEMS FROM THE PRIOR PACIFICORP RATE CASE, DOCKET NO. 04-035-42, IN WHICH ACTUAL CIRCUMSTANCES DIFFERED SUBSTANTIALLY FROM THE PROJECTIONS PRESENTED IN THAT CASE?

A. Yes. In PacifiCorp's prior rate case, Docket No. 04-035-42, a future test year ending March 31, 2006 (fiscal year 2006) was stipulated to and used by the parties in making their revenue requirement recommendations. In that case, the Company assumed 488 additional employees would be on the payroll in the test year ending March 31, 2006, with 376 of those 488 additional employee positions being added by March 2005. In its direct testimony, the Committee raised concerns with the projected employee additions and recommended several adjustments. The Company continued to support its projected employee additions and did not provide any indication that there would be a reduction in employee levels. The Stipulation in that docket was executed in February 2005.

According to PacifiCorp Exhibit JTW-1 in the current proceeding, at page 4.9.1, the Company incurred severance costs that it booked in June 2005 for a "rebasing initiative." PacifiCorp's response to Master Data Request B ("MDR B") 21 in this case provided some additional information on the "rebasing" program. Included with the response as Attachment

21.1 was a document entitled “Outcomes of the Rebasing Project – Business Unit Rebasing Initiative Slides” dated June 17, 2005. Throughout the document are references to employee reductions from the budget. Regarding employees that were eliminated the Company is requesting the recovery of associated severance costs in the current case as part of its adjustments on page 4.9.1 of Exhibit JTW-1.

This large change in “employee count” from the manpower levels incorporated in the future test year demonstrates that projections are potentially subject to significant changes and may be unreliable. The “rebasing initiative” exemplifies the kinds of concerns regulators should have regarding whether or not a utility is providing full disclosure of events that may occur in the period leading up to and during the future test year.

Q. ARE THERE ANY MAJOR CHANGES INVOLVING PACIFICORP’S OPERATIONS THAT MAY ADD TO THE UNCERTAINTY OF THE COMPANY’S PROJECTIONS IN THIS CASE?

A. Yes. First, PacifiCorp was recently acquired by MEHC. Many changes in investment, operations and corporate structure have already been identified as part of the acquisition approval process. Additional changes have occurred since the completion of the acquisition. Additionally, a business plan to be approved by MEHC will supplant the business plan developed under the auspices of ScottishPower. While PacifiCorp has filed supplemental testimony on some of the impacts of the acquisition on the proposed test year, it is likely that additional acquisition-related changes impacting costs in various areas will occur prior to September 30, 2007.

Second, the current filing includes a high level of projected capital expenditures in the areas of generation, transmission and distribution plant. There is the potential for project slippage and uncertainty regarding the Company's ability to meet such an aggressive construction schedule with available resources.

Q. PLEASE EXPLAIN IN DETAIL WHY THE MEHC ACQUISITION OF PACIFICORP RESULTS IN GREATER UNCERTAINTY ASSOCIATED WITH USING A FUTURE TEST YEAR IN THIS CASE?

A. The Company has not yet prepared or finalized the operating plans and budgets for the period after March 2007 based on post-acquisition conditions. The operating plans and budgets provided by PacifiCorp in response to discovery are based upon information prepared under ScottishPower ownership and assumed continued ScottishPower ownership. The fiscal year ending March 31, 2007 budget provided by PacifiCorp was approved by ScottishPower in the fiscal year ending March 31, 2005. Additionally, those budgets were prepared prior to the "Rebasing Initiative" program discussed previously.

According to the response to CCS DR 7.5, "The new PacifiCorp leadership is currently developing goals for each of their business areas for the balance of calendar year 2006." The response indicates that it is anticipated the goals would be finalized by the end of May 2006. On June 6, 2006, the Company provided the MEHC-approved PacifiCorp 2006 goals for the nine-month period ending December 31, 2006. To the best of my knowledge, formal goals and operating plans have not been finalized for 2007 based on input or direction from MEHC, and recent conversations with Company representatives suggest that those goals and operating plans may not be finalized until later this year. This makes the capital investment, O&M and A&G budgets more speculative than may otherwise be the case.[2]

Q. DO YOU HAVE ANY CONCERNS WITH THE REVENUE FORECASTS PRESENTED BY THE COMPANY IN THIS CASE?

A. Yes. The load and retail sales forecasts used in the Company's proposed future test year are addressed in the direct testimony of PacifiCorp witness Mark Klein. Throughout his testimony, Mr. Klein indicates that the forecasts included in the case were "adjusted." When discussing the forecasted number of customers in the Residential, Commercial, Public Street & Highway Lighting and Irrigation customer classes, he states,

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[2] Regarding the level of operating costs included in its requested September 2007 test year, PacifiCorp is projecting increases of $17.4 million (absent the application of inflation factors) on a Utah basis associated with Power Delivery Programs (T&D). In the generation area, PacifiCorp is projecting increases of $14.5 million (absent the application of inflation factors) on a Utah basis associated with generation plant maintenance and overhaul expenditures. These areas represent large forecasted increases above the historical 2005 levels and may be subject to review and modification by MEHC.

beginning at page 5 of his testimony, that “The forecasts are then reviewed for reasonableness and adjusted if appropriate.” Later on the same page when addressing how the average use per customer for these classes was forecast, Mr. Klein indicates that: “The forecasts are reviewed for reasonableness and adjusted if appropriate.”

When addressing the forecasting methodology for the Industrial and Other Sales to Public Authorities customer classes, on page 6 of his testimony, Mr. Klein states that: “The forecasts are reviewed for reasonableness and adjusted if needed.” When addressing how the monthly forecast of sales and consumers for these classes are developed, he indicates that: “The distributions are reviewed by looking at year-on-year growth to make sure they reflect reasonable values. If they do not, then the forecasts will be adjusted.”

In DPU DR 1.30, PacifiCorp was asked for each of the above quotes to explain which forecasts included in the filing were adjusted and to explain each of the adjustments, along with the general reasoning behind each adjustment. PacifiCorp’s response was as follows:

> The Company does not keep specific details on the forecasts to explain which were adjusted in the current rate case. In a general sense, forecasts are adjusted when growth rates seem unreasonable from historic levels without known cause, or period to period changes are counter to historical relationships, or there are known changes the models will not include.

DPU DR 1.10(d) referred to Mr. Klein’s testimony, at lines 133 – 137, in which he addresses the Industrial and Sales to Other Public

Authorities forecasts, and asked the Company to explain any adjustments that were made to the forecasts as a result of the review for reasonableness. The response stated that "The current process does not allow for retention of judgments and adjustments made to ensure reasonable values…" In response to DPU DR 1.10(b), PacifiCorp responded that "Often the second year of a forecast will not produce reasonable values and will require adjustment…"

Q. ARE YOU CONCERNED ABOUT PACIFICORP'S APPARENT INABILITY OR UNWILLINGNESS TO PROVIDE DETAILED EXPLANATIONS REGARDING THESE REFERENCED ADJUSTMENTS TO THE FORECAST RESULTS IN DERIVING THE PROPOSED SALES AND REVENUE LEVELS CONTAINED IN THE COMPANY'S FILING?

A. Yes. It is important for parties to be able to examine the reasonableness of all critical assumptions made by the Company in determining the forecasted load and sales levels. The Company's testimony describes its various forecasting processes and models for projecting customer counts, use per customer and overall sales volumes. However, "after-the-fact" adjustments which Mr. Klein's testimony indicates were made to some of the resulting forecasts, and which the Company is apparently now unable to adequately explain because it failed to retain the necessary information, undermine the credibility and verifiability of the proffered information. The inability of the Company to satisfactorily explain and document the underlying basis for its adjustments in this key area is problematic and should be viewed by regulators as unacceptable.

<u>TEST YEAR SELECTION</u>

Q. AS A GENERAL RULE WHAT IS THE COMMITTEE'S PREFERENCE WITH REGARDS TO TEST YEAR?

A. Generally, the Committee prefers a historical test year with known and measurable changes --so long as known and measurable adjustments are consistently applied to ensure the proper matching between the ratemaking components of investment, revenue and expense. The information used for a historical test year will typically be more accurate and reliable compared to a future test year, especially one going out up to 20 months.

Q. GIVEN THE ADVANTAGES THE COMMITTEE SEES WITH USING A HISTORICAL TEST YEAR WITH KNOWN AND MEASURABLE CHANGES, AND THE CONCERNS YOU IDENTIFY WITH USING A FUTURE TEST YEAR, WHY IS THE COMMITTEE NEVERTHELESS SUPPORTING THE USE OF A FUTURE TEST YEAR IN THIS CASE?

A. Section 54-4-4(3)(a) of the Utah Statutes requires that the Commission select a test period that, on the basis of the evidence, it finds best reflects the conditions that a utility is expected to encounter during the rate effective period. PacifiCorp is anticipating significant cost increases in the areas of O&M and new capital investment. Consequently, a future test year ending September 30, 2007, ***if properly adjusted and with reasonable ratepayer safeguards in place***, will be more reflective of the conditions PacifiCorp is expected to encounter during the rate effective period compared to other test year alternatives.

The Utah service territory is currently in a period of expansion and is experiencing (and projected to experience) increases in capital investment that transcends historical levels. Sustained load growth in Utah, particularly in the peak periods, is causing the need for new capital investment in generation, transmission and distribution plant. The relatively higher load growth in Utah (compared to other jurisdictions) also increases various allocation factors. Thus, Utah is picking up a greater share of total system cost responsibility.

Additionally, the Committee has raised concerns in other forums regarding the reliability of PacifiCorp's sub-transmission and distribution network and its past maintenance and investment commitments. In its filing, PacifiCorp is proposing additional investments in the sub-transmission and distribution network and higher power delivery-related operating and maintenance costs, which the Committee believes will improve the performance and reliability of the network.

Many of the key cost drivers are expected to occur beyond the mid-period (year ending September 30, 2006) presented by the Company in this case. For example, PacifiCorp currently projects that the Lake Side

Plant, which has an estimated cost of $347 million, will go into service in May 2007, five months prior to the end of the future test year. Once the Lake Side Plant is in service, it will impact not only rate base, but also depreciation expense, net power costs and revenues. The second phase of the Currant Creek generating plant, estimated at a cost of $187 million, is only reflected as being in service partially in the mid-period, but will be in service for the entire future test year. The Huntington Unit 1 Scrubbers, estimated at a cost of $135 million, are anticipated to be placed into service in November 2006, which is during the future test year. The installation of the scrubbers is a significant investment that will impact the balance between investment, revenue and expense.

DISCUSSION OF RATEPAYER SAFEGUARDS

Q. EARLIER IN YOUR TESTIMONY YOU STATED THAT, WHILE THE COMMITTEE WAS SUPPORTING THE COMPANY'S PROPOSED FUTURE TEST YEAR, SUPPORT WAS CONDITIONAL ON SAFEGUARDS BEING PUT INTO PLACE TO BETTER ASSURE THAT THE COMPANY'S FORECASTED COSTS ARE CONSISTENT WITH WHAT ACTUALLY OCCURS IN THE RATE EFFECTIVE PERIOD. WHAT CONCERNS GIVE RISE TO THE NEED TO DEVELOP RATEPAYER SAFEGUARDS?

A. While the Committee is still in the process of analyzing the Company's responses to discovery regarding projected capital and O&M/A&G

expenditures, there is a very real concern that the significant level of projected expenditures in these areas may not be achieved. If the September 30, 2007 future test year is adopted by the Commission, the Committee believes that safeguards need to be established to protect ratepayers in the event that actual capital spend levels fall substantially short of projected levels and actual cost increases in the areas of O&M/A&G fall short of budgeted levels.

Q. DOES THE COMMITTEE HAVE ANY SPECIFIC SAFEGUARDS OR RATEPAYER PROTECTION MEASURES TO OFFER FOR CONSIDERATION AT THIS TIME?

A. Such safeguards could take various possible forms. We have initially considered three types of safeguards to protect customers: (1) the phasing-in of rate recovery of costs ascribed to particular major projects or initiatives in the outer months of the test year based on achieved project milestones; (2) the establishment of deferral mechanisms (perhaps in the form of a regulatory liability) to mitigate future cost increases; or (3) customer credits (refunds) on bills essentially reflecting the difference between amounts collected in rates and actual spend levels. The Committee will further address such safeguards in its revenue requirement testimony.

Q. DO YOU HAVE ANY FINAL REMARKS REGARDING MATTERS RELATING TO TEST YEAR?

A. Yes. PacifiCorp is basically a Company in transition at many levels. That transition will likely occur in stages and may have a direct and material bearing on the costs requested for recovery by the Company in this rate case. If a future test year extending out twenty months to September 30, 2007 is adopted by the Commission, it is imperative that the Commission require PacifiCorp to fully disclose any anticipated changes that may occur through the end of the test year, as such information and events are largely within the Company's control.

Q. DOES THIS COMPLETE YOUR PREFILED TESTIMONY ON TEST YEAR ISSUES?

A. Yes.