Docket No. 06-035-163
Docket No. 07-035-14
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DPU Exhibit No. 1.0
David T. Thomson
September 10, 2007

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power, a Division of PacificCorp, for a Deferred Accounting Order To Defer the Costs of Loans Made to Grid West, the Regional Transmission Organization	:	Docket No. 06-035-163
In the Matter of the Application of Rocky Mountain Power for an Accounting Order to Defer the Costs Related to the MidAmerican Energy Holdings Company Transaction.	:	Docket No. 07-035-04
In the Matter of the Application of Rocky Mountain Power for an Accounting Order Costs related to the Flooding of the Powerdale Hydro Facility	:	Docket No. 07-035-14

DIRECT TESTIMONY

OF

DAVID T. THOMSON
STATE OF UTAH
DIVISION OF PUBLIC UTILITIES

SEPTEMBER 10, 2007

Q. Please state your name and business address for the record.

A. David T. Thomson. My business address is Heber M. Wells Building 4th Floor, 160 East 300 South, Salt Lake City, Utah 84114-6751.

Q. For which party will you be offering testimony in this case?

A. I will be offering testimony on behalf of the Utah Division of Public Utilities ("Division").

Q. Please describe your position and duties with the Division of Public Utilities?

A. I am a Technical Consultant. Among other things, I serve as an in-house consultant on issues concerning the terms, conditions and prices of utility service; industry and utility trends and issues; and regulatory form, compliance and practice relating to public utilities. I examine public utility financial data for determination of rates; review applications for rate increases; conduct research, examine, analyze, organize, document and establish regulatory positions on a variety of regulatory matters; review operations reports and ensure compliance with laws and regulations, etc.; testify in hearings before the Public Service Commission ("Commission"); assist in analysis of testimony and case preparation; and participate in settlement conferences, etc.

Q. Please summarize the Division's recommendations as to these three Dockets.

A. The Division recommends that the application to defer the cost of loans made to Grid West be denied by the Commission. The costs do not meet the Division's guidelines for deferred accounting treatment. (See exhibit 1.1) The application fails multiple portions of the Division's guidelines in that it was not extraordinary and an unforeseen event, the Utah portion is not material, and there is no future net benefit to ratepayers.

The Division recommends that the transition costs ($6.4 million) in the rate case settlement Docket No. 06-035-21 be denied deferred accounting treatment. The Division's position is that they were part of the stipulated settlement and a deferred accounting order for those costs is not appropriate. The Company should not be able to change the stipulation and get an amortization.

The Division recommends that the transition costs in the application that were not addressed in Docket No. 06-035-21, the transitions cost not considered in Docket No. 06-035-21, ($39 million) also be denied deferred accounting treatment. The Division believes these costs would or could have been foreseen and should have been included in the past rate case.

The Division recommends that the application to defer the costs related to the flooding of the Powerdale Hydro Facility meets the Division's guidelines for deferred accounting treatment and should be granted deferred accounting treatment.

Q. Please explain how you arrived at the above recommendations.

A. The Division has guidelines for what costs qualify for deferred accounting. It is the Division's position that if these guidelines are not met then a deferred accounting order should not be granted by the Commission. These guidelines have been put forth in other filings before the Commission and those guidelines are outlined in Exhibit 1.1.

The Division has concerns for transition costs that it has considered, that are not part of its guidelines in exhibit1.1, that it believes warrant the denial of deferred cost accounting. In addition to the guidelines in exhibit 1.1, the Division also believes that costs in a deferred accounting order should be given some initial consideration by the applicant as to qualification for rate recovery.

Q. Does the Division have any concerns with the filing of these three deferred accounting applications?

A. Yes. Within the space of four months, Rocky Mountain Power ("RMP") submitted three deferred accounting applications with the Commission. The Applications for Deferral for Grid West - Docket No. 06-035-163 and Transition costs – Docket 07-035-04 were filed December 2006 and January 2007, respectively. The Powerdale Hydro application was filed March 2007. Upon review of the first two applications, the Division had concerns that the costs do not meet the Division's guidelines for deferred accounting qualification. The Division also believes these costs, outside of its guidelines, would not qualify for deferred accounting.

These applications have provided the Division the opportunity to discuss its guidelines for what costs qualifies for deferred accounting. The Division sees a need for the Commission to clarify its policy on when an application can be made for a deferred accounting treatment, what is addressed in the application process and what is ordered after the process is completed. This clarification is especially needed in light of the provision in the law for a future test year and the increased frequency in filing rate cases in electric regulation in Utah.

Q. Please explain why the Grid West costs do not qualify for deferred accounting.

A. Using the Division's guidelines, the Grid West costs do not qualify for deferred accounting for the following reasons. First, the costs are not extraordinary and could have been foreseen and included in a past rate case. In response to the Committee of Consumers Services data request No. 1.27 under Docket 06-035-163 which asked "When was the Company first aware that Grid West would cease activities?" The responses was as follows:

> After two utilities had withdrawn from continued support and funding for Grid West in late 2005, the Company assisted in development of a streamlined business model for consideration of Grid West funders. In February and March 2006, the Company evaluated Grid West's proposal and its chances of success. It concluded that even if funders had sufficient interest and commitment to justify moving forward, it was unlikely that Grid West could support its loan burden if it were to implement the more limited services and markets contemplated at that time. After several additional funders decided to withdraw, the Company determined that continued development efforts were no longer justified and therefore supported the Grid West Board of Directors' recommendations to dissolve.

The Division believes that RMP had adequate time and knowledge of the Grid West situation to present this information in its last rate case filing or at least during the proceedings of the last rate case which was filed March 2006. Applications were filed immediately in three states in March 2006 when the Company supported dissolution of Grid West, thus enabling the Company to determine the worthlessness of its loans to the Grid West entity. (See Exhibit 1.2 for the Divisions summary of RMP's filings in all jurisdictions for deferred cost addressed in this testimony)

At a minimum RMP could have filed for a deferred accounting application in March like it did in other states. This would have brought to light the costs for consideration for future rate recovery or consideration in settlement negotiations. However, RMP did not file its application in Utah until December 2006 long after it negotiated a settlement in the last rate case which took place during July 2006.

Second, the Grid West loans have no future net benefit to ratepayers. The Division believes the Company has failed to demonstrate any net future benefits that customers have received as a result of the Grid West funding.

Third, the costs to be deferred for Grid West are not material. Judgment is required in addressing the materiality of costs perceived as extraordinary and unforeseen and having net future benefit. The Division could find no hard fast rules in accounting literature relating to materiality.

The Securities and Exchange Commission in Staff Accounting Bulletin No. 99 on materiality states the following:

> The use of a percentage as a numerical threshold, such as 5%, may provide the basis for a preliminary assumption that –

without considering all relevant circumstances – a deviation of less than the specific percentage with respect to a particular item on the registrant's financial statements is unlikely to be material. The staff has no objection to such a "rule of thumb" as an initial step in assessing materiality. But quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations. Materiality concerns the significant of an item to users of a registrant's financial statements. A matter is "material" if there is substantial likelihood that a reasonable person would consider it important. In its Statement of Financial Accounting Concepts No. 2, The Financial Accounting Standards Board stated the essence of the concept of materiality as follows:

The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the items is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influence by the inclusion or correction of the item.

This formulation in the accounting literature is in substance identical to the formulation used by the Courts in interpreting the federal securities laws. The Supreme Court has held that a fact is material if there is – a substantial likelihood that the …..fact would have been viewed by the reasonable investor as having significant altered the "total mix" of information made available.

Under the governing principles, an assessment of materiality requires that one view the facts in the context of the 'surrounding circumstances,' as the accounting literature puts it, or the "total mix" of information, in the words of the Supreme Court. In the context of a misstatement of a financial statement item, while the "total mix" includes the size in numerical or percentage terms of the misstatement, it also includes the factual context in which the user of financial statements would view the financial statement item. The shorthand in the accounting and auditing literature for this analysis is that financial management and the auditor must consider both "quantitative" and "qualitative" factors in assessing an item's materiality. Court decisions, Commission rules and enforcement actions, and accounting and auditing literature have all considered "qualitative" factors in various contexts.

However, the Federal Energy Regulatory System ("FERC") system of accounts for electric and gas utilities defines materiality, relating to an extraordinary item, as approximately 5% of income, computed before extraordinary items and FERC approval must be obtained to treat an item of less than 5 percent as extraordinary. (18 CFR Ch.1 part 101, p 293 [4/1/03 Edition] – definition of extraordinary items) The Division would like to note that the Utah Commission has granted deferral for costs under 5%.

The amortization term also affects materiality on a year to year basis. Subject to the length of the amortization, a cost may or may not be material in a given yearly period. For example, if one felt that $1 million is material for deferred accounting treatment for a yearly period, and then a total $5 million deferred cost amortized over 5 years is material. However, if the $5 million is amortized over 10 years it is not. In determining materiality for deferred costs the Division believes the effect of the deferred costs on rate of return or income from operations could be used to assist in judging materiality.

The Division believes the burden of proof as to materiality should rest with the applicant. The Division believes that the FERC threshold of 5% of income before extraordinary items is a good starting point and any cost below this threshold should be justified by the applicant. Taking Utah's $1.1 million cost deferral for Utah for Grid West loans and amortizing the costs by three years gives a yearly cost amount of $367,000. The Division believes this yearly amount and the total amount are immaterial. The total is less than 1% of utility net operating income and the yearly amortization amount has no material significance to rate of return. If a longer amortization term is used the yearly amount becomes even more immaterial.

However, if the cost is deemed material by the applicant, the Division believes this is evidence that the event should be important enough that the deferral accounting application be filed as soon as possible after the event has taken place. Again, the Division notes that the Grid West application for Utah was filed in December 2006 with other applications for Grid West being filed in March 2006 with Wyoming, Oregon and Idaho. (See exhibit 1.2) March was when the Company determined the loan was uncollectible. (I reference the filings from other states in this testimony for timing purposes only and not to address how other States handled these deferred accounting applications. The handling of these applications is a matter for this jurisdiction and these Dockets.)

Finally, the Division is troubled that RMP now seeks to shift the burden of its funding of Grid West's expenses through loans to ratepayers. The Grid West organization was set-up, run for six years, and ended outside the utility organization, regulation and accounting records except as a third party loan. Any costs, loans or expenses of this organization should not rest with ratepayers.

The Division believes that the way Grid West was organized and funded precluded it from the opportunity for future rate recovery before this Commission.

For rate recovery to take place, the Division believes that ratepayers from the beginning should have had the opportunity to review the cost underlying the loans as being prudent, fair, reasonableness and for adherence to this Commission's policies for rate recovery. This did not happen. Ratepayers do have the opportunity for judging prudence of costs related to other FERC activities and expenses related to the Company because such activates are included in normal operational expenses of the Company. In fact, Company expenses for Grid West have been included in past rate case filings. The Grid West loan should not now become a responsibility of ratepayers.

Q. Please explain why the transition costs do not qualify for deferred accounting.

A. I will first address why the transition costs that were included in the last rate case do not qualify for deferred accounting.

There should be no deferral of costs if such costs were part of a rate case that had a stipulated settlement and if such costs were not referenced to specific treatment in the stipulation. Another way of putting this is that there cannot be a future amortization of costs unless that amortization is spelled out in either a deferred accounting order or a rate case decision either by stipulation or by order.

This reason is unique to Docket No. 07-035-14. It relates specifically to the first part of the application relating to the deferral of transition costs of $6.4 million that were put forth by RMP in its last rate case in Docket No. 06-035-21.

Due to the settlement, the Commission had no opportunity to issue an order authorizing deferral of the transition costs or to establish transition cost amortization.

The last rate case took place with a partial “black box” settlement and a stay out provision. Rates went forward from the settlement and stay out provisions. The Division believes that items under the settlement should only be addressed to future periods if specifically addressed in the settlement. This is due to the fact that the final components under the settlement that make up the revenue requirement have not been determined. Since components have not been determined, it is not possible at a later date to address a specific cost as a deferral because it is assumed that all remaining issues are included in the settlement.

The Division notes that some items were specifically outlined in the settlement such as rate of return, revenue requirement, rate credit, rate spread, retail load forecast, stay out provision, Power Cost Adjustment Mechanism and other items. RMP had the opportunity to include the amortization of the transition cost in the stipulation but it did not.

Since it is not specifically in the settlement stipulation, the Division believes it does not qualify for a deferral. Again, the Division believes this qualification is unique to the “black box” settlement stipulation and, if deferrals are specified in future settlements, then this reason for not qualifying will disappear because of a lack of relevancy.

Second, as to the next part of the transition costs of $40 million that was not contemplated in the last rate case, the Division believes there should be no deferral of cost because they would or could have been foreseen or should have been included in the last rate case.

In his Direct Testimony to these Dockets, Mr. Jeffery K. Larsen discusses the rule against retroactive ratemaking and whether the rule prohibits the Company from deferring the costs that it has requested in these Dockets (See lines 133 to 142). He states the following:

> The rule against retroactive ratemaking only applies to a rate setting proceeding in which the utility is attempting to recover past expenses or in which it is being required to refund past revenue that were contemplated in setting rates in the prior proceeding. When the estimates of cost and revenues prove to be inaccurate and **costs are either higher or lower than predicted, the rates cannot be changed to correct for the error.** As such, the rule prohibits refunds when rates were set too high and surcharges when rates were too low. (Emphasis added)

The Division believes that if deferred costs were not contemplated but should have been contemplated, or were not predicted but should have been predicted in a future test year filing, returning to the prior period to correct the non-contemplated or non-predicted cost (a "misstep") is retroactive ratemaking.

The utility has control and the best information of what is included or not included in the rate case filing (including whether costs should be deferred) for revenue requirement. If it puts forth its best effort to prepare an accurate rate case filing, then there should be a high probability of the capture of all foreseeable costs, including deferred costs. An accurate and fully complete filing would limit the need for a deferred accounting order till the end of the rate effective period or the filing of a future rate case except for unforeseen and extraordinary events. The utility would not need to take a second bite of the apple to try and recover a deferred cost which it may have not predicted but should have predicted in electing to use a future test year. The Division believes one should not only determine what costs were not considered in the prior rate case but also why they were not considered. Were they not considered because they were poorly predicted or not predicted or not included but should have been included? Or, were they not considered because they were unforeseen or extraordinary? As stated above, "when the estimates of costs and revenues prove to be inaccurate and costs are either higher or lower than predicted, the rates cannot be changed to correct the error."

The transition costs of a number of employees were included in the last rate case, but it appears not enough were included. Deferred accounting applications for transition costs were filed in May 2006 for Wyoming, Oregon and Washington. (See exhibit 1.2) It appears from the above filing dates that additional transition costs other than those already in the filed rate case were known to be taking place in early 2006, which was during the last rate case in Utah. In a filing with the Idaho Public Service Commission in October 2006, the Company stated, "The Costs of the Transition severance plan is anticipated to exceed $25 million on a total company basis." In response to Committee of Consumer Services data request No. 1.8; the Company provided confidential information about the severance cost by displacement dates. The total displacement costs by month were broken down by the Division from that Data response and are shown in confidential Exhibit 1.4. It appears from the exhibit that RMP knew that significant numbers of employees and related severance costs along with related salary saving were taking place during the last rate case. Why weren't these significant numbers included in the future test year filing? The Division believes the additional severance costs not in the rate case should or could have been contemplated and should or could have been predicted in the last rate case filing. To not include them in the filing was to err in future test year prediction of costs.

At a minimum RMP could have filed for a deferred accounting application in May 2006 as like they did in other states. This would have brought to light the costs for consideration for future rate recovery or consideration in settlement negotiations. However, it did not file its application in Utah until January 2007, long after it negotiated a settlement in the last rate case which ended in July 2006.

In its data request 2.24 to this Docket, the Division asked the following, 'What are the Company's criteria for determining when information relating to expenses or revenue in rate case filing is beyond "lockdown of results to complete the case filing,' The Company responded as follows:

> There is no specific time frame associated with the lockdown of results and will be determined on a case-by-case basis. The lockdown of results occurs when no further changes are made to revenue requirement so that sufficient time is provided to perform the costs of service study and prepare the company's final rate spread and pricing proposal.

If "locking down" a rate case is on a case-by-case basis, in other words is at the discretion of management as to when that takes place, then the Division believes that the locking down of changes to the revenue requirement could have been modified or postponed at management's discretion to ensure that the anticipated Grid West and forecasted transition costs were included in the last rate case. The Company is in control of the timing of the filing of a rate case.

The Division believes that great care should be given to include all foreseeable cost benefit actions in a rate case. Locking down the rate case filing (February/March 2006), negotiating a stipulated rate requirement settlement (July 2006) in Utah, and then filing an application in January of 2007 in Utah for severances cost that should or could have been contemplated or forecasted during the rate case, in the eyes of the Division, is a misstep in forecasting and is an attempt to take another bite of the apple and disqualifies the cost for deferred accounting application.

Q Please explain why the Powerdale Hydro costs qualify for deferred accounting.

A. Using the Division's guidelines, the event and its related cost qualifies for deferred accounting because it was unforeseen and extraordinary. The costs are most likely material and should qualify for rate recovery. The Division agrees that a regulatory asset in Account 182.2 could be established consisting of the original book value of the asset in Account 101 decreased by the actual accumulated provision for depreciation from Account 108. Insurance proceeds should also offset the net cost, if any. Since it is an early retirement of an asset, net salvage value should also be considered.

The Division at this time has no input as to the amortization period other than it request that the Commission consider that the net plant costs should not be amortized beyond the end of the dismantling of the plant. Considering a start date of January 1, 2007, a 3 to 5 year amortization would appear to be reasonable.

The Division suggests that the amortization start January 1, 2007. We note that in November 2005, the Company had a FERC order permitting generation until April 10, 2010, at which time the plant was to be dismantled. We are concerned that this information and proper accounting for the plant decommissioning cost activity was not presented in the last general rate case. When preparing their last rate case, the Company knew that the plant was going to be decommissioned per FERC order, its license efforts terminated and that it would not be generating electricity past April 10, 2010. Depreciation rates that were being used should have been terminated at the time it was known that the plant had a decommission date in 2010, and the depreciation/amortization of the remaining costs over the remaining life of the plant should have been addressed in the last rate case.

The Division does not know how those costs would have been treated in the last rate case. It is possible that if the amortization had started at the FERC order date the amortization of the remaining plant costs now would be lower because the amortization of costs from prior periods would be higher than the depreciation rate (4.2%), which the Division assumes is still being applied at the time of this testimony, to depreciate the cost of the plant. Amortization costs have been delayed and pushed into future accounting periods and possibly future test years.

The Division will address its concerns, if it has any, as to rate recovery in the next rate case.

Q. Does the Division have an accounting position for the decommission costs?

A. No, not at this time. Since the decommissioning cost will not start until April 2010, there is no need to address these costs prior to the next rate case. However, the Division believes that the decommissioning costs should be addressed in the next rate case as to amortization, amortization start date and recovery. The Commission, as part of its Order in this Docket could make this a requirement.

Q. Once a cost qualifies for a deferred accounting what should happen next?

A. The Division believes that an order from a deferred cost application should put forth or address certain items. The items would be addressed through hearing procedures, *i.e.* technical conferences, discovery and testimony. The Division would like to suggest the following be part of the order issued by the Commission.

The first suggestion is that the Commission continues to state the period for the amortization of the costs in the final deferred accounting order. The Division also believes the amortization period should be of proper length that costs are matched to the life of the benefit. The burden for putting forth the life of the benefit should be on the applicant. The method or analysis used to determine benefit life should be disclosed in the application. The Division notes that in past deferred accounting orders, the Commission has used a wide variety of amortization lives based on its analysis of the cost and the circumstances surrounding the costs in the application. (See exhibit 1.3)

The second suggestion is that the Commission continues, as it has done in the past, to state the start date of the costs to be amortized. The Division believes that the amortization of the costs should begin at a date that best enables the proper matching of cost amortization to benefit life. If the cost amortization begins at the start of the future benefit and the amortization of such costs run the life term of the benefit, you have a perfect matching of cost to benefit. Any unnecessary delays in starting the amortization period will create a mismatch due to the benefit life running and the matching costs are being held in abeyance. Retroactively setting a date to create proper matching would correct this problem but accounting for the deferred costs prior to the final determination of cost treatment would be misstated until the correct timing of cost recognition is given by the Commission.

Q. What would be the Division's recommendation for amortization start date and length if the Commission accepts the Grid West and Transition cost for deferral accounting?

A. For Grid West the Division would accept the three year amortization put forth by the Company in its filed testimony and would recommend a starting date of March 2006.

For the Transition cost the Division would accept the start date put forth by the Company in its filed testimony and would recommend a five year life.

Q. Does this conclude your Testimony?

A. Yes.