

1 **Q. Please state your name, business address and position with PacifiCorp (the**  
2 **Company).**

3 A. My name is Henry E. Lay. My business address is 825 N.E. Multnomah Street, Suite  
4 1900, Portland, Oregon, 97232. I am employed by the Company as corporate  
5 accounting controller.

6 **Q. Please briefly describe your professional experience and educational**  
7 **background.**

8 A. I have a Bachelor of Science degree in Accounting from the University of Utah. I  
9 have worked for the Company for over 33 years, primarily in corporate accounting  
10 management roles. The areas for which I have been responsible include asset\plant  
11 accounting, corporate\general accounting, regulatory accounting and customer  
12 accounting. I have personally prepared depreciation studies for the Company prior to  
13 the Company engaging a consultant to do this work, and I have participated in and  
14 reviewed the results of the consultant's studies previously submitted to state  
15 regulatory commissions for approval, as well as the present study.

16 **Q. What is the purpose of your testimony?**

17 A. I summarize the Company's proposal for depreciation rates and provide a summary of  
18 the effect on annual depreciation expense from applying the proposed depreciation  
19 rates to depreciable plant balances. The proposed rates are contained in the 2007  
20 depreciation study performed on behalf of the Company by Mr. Donald S. Roff of  
21 Depreciation Specialty Resources. The depreciation study performed by Mr. Roff is  
22 provided as Exhibit RMP\_\_\_\_(DSR-3) and will be referred to hereafter as the DSR  
23 study.

24 I introduce the other Company witnesses who will testify in this proceeding  
25 and provide a brief description of the subject matter on which they are testifying. I  
26 also provide background information describing the depreciation study process. This  
27 information will present the Company's confidence in both the depreciation study  
28 process and in the integrity of the Company's accounting data relied on by Mr. Roff  
29 in preparing the depreciation study.

30 I identify and discuss a number of significant issues considered during the  
31 preparation of this study. The disposition of these issues was reflected in the data  
32 provided to Mr. Roff and, in turn, this data formed the basis for the DSR study and  
33 the recommended changes in depreciation rates. I also support the Company's  
34 proposed effective date for implementing the changes in depreciation rates.

35 **PLANT LIVES, DEPRECIATION RATES AND DEPRECIATION EXPENSE**

36 **Q. Please explain the depreciation rates the Company is seeking commission**  
37 **approval for in this proceeding?**

38 A. The Company seeks commission approval to adopt the depreciation rates contained in  
39 the depreciation study performed by Mr. Donald S. Roff and as recommended in Mr.  
40 Roff's testimony. As shown in Table A of Exhibit RMP\_\_(DSR-3) and as  
41 summarized in Mr. Roff's testimony, the depreciation study proposes a reduction of  
42 0.22 percent to the current composite depreciation rate of 2.91 percent for the  
43 Company's electric utility plant resulting in a new composite depreciation rate of 2.69  
44 percent. This composite rate is based on the December 31, 2006 depreciable plant  
45 balances used in the study. The specific depreciation rate changes recommended for  
46 the components of the composite depreciation rate are set forth in account detail in

47 Schedule 1 of Exhibit RMP\_\_\_\_(DSR-3) of the depreciation study.

48 **Q. What is the effect on annual depreciation expense if depreciation rates**  
49 **recommended by Mr. Roff are adopted?**

50 A. The effect of applying the recommended depreciation rates to the December 31, 2006  
51 depreciable plant balances is a decrease in total Company annual depreciation  
52 expense of approximately \$30.6 million, compared with the level of annual  
53 depreciation expense developed by application of the currently authorized  
54 depreciation rates to the same plant balances. Annual depreciation expense by  
55 functional plant classification is summarized in Table A of the DSR study.

56 Adoption of the depreciation rates proposed in the DSR study results in a  
57 decrease of approximately \$10.0 million in annual Utah jurisdiction depreciation  
58 expense, based on December 31, 2006 depreciable plant balances. The calculation of  
59 the Utah jurisdiction amount is described in Exhibit RMP\_\_\_\_(HEL-1).

60 **INTRODUCTION OF WITNESSES**

61 **Q. In addition to yourself, who will be testifying on behalf of the Company in this**  
62 **proceeding?**

63 A. In addition to me, two witnesses will testify on behalf of the Company. These  
64 witnesses are Mr. Donald S. Roff, President of Depreciation Specialty Resources and  
65 Mr. Mark C. Mansfield, vice president, thermal operations for PacifiCorp Energy.

66 Mr. Roff will present the depreciation rates for which the Company is seeking  
67 Commission approval. He describes how the depreciation study was prepared and  
68 discusses the primary reasons for the recommended changes in depreciation rates.  
69 The first reason Mr. Roff discusses is the effect on depreciation rates of using the

70 estimated plant depreciable lives described in Mr. Mansfield's testimony. He also  
71 discusses the effect on depreciation rates due to additional negative net salvage for  
72 terminal removal of generation facilities. In addition, he will discuss the additional  
73 negative net salvage related to transmission and distribution plant assets, the decrease  
74 for which is reflective of the Company's current\historical removal and salvage  
75 experience. Mr. Roff also discusses the effect on depreciation rates of additional  
76 investment in plant, installed since the 2002 depreciation study and the reason for  
77 inclusion of nominal interim additions for facilities with terminal removal dates in the  
78 current study. The 2002 depreciation study was the basis for the stipulation approved  
79 by the Commission in Docket No. 02-035-12.

80 Mr. Mansfield will describe the process used by Company engineers to develop  
81 estimated plant depreciable lives for steam generating stations. He will explain how  
82 steam estimated plant depreciable lives provide a framework for estimating the  
83 retirement date for each steam plant. In a similar manner he will describe the  
84 procedure used to estimate the retirement date for the Company's hydroelectric  
85 generating stations. He will demonstrate that the estimated retirement dates proposed  
86 by the Company for both steam and hydro generation plants are reasonable and  
87 prudent and are appropriate inputs for Mr. Roff's depreciation analysis. Mr.  
88 Mansfield will also explain why the rates the Company proposes to include as  
89 terminal net salvage, or "decommissioning costs," in the calculation of depreciation  
90 rates for generating plants are reasonable and prudent.

91

92 **DEPRECIATION STUDY BACKGROUND**

93 **Q. Was the DSR study prepared under your direction?**

94 A. Yes. As corporate accounting controller, I have responsibility for the Company's  
95 corporate accounting departments and for ensuring compliance with Company  
96 accounting policies and procedures. This includes periodic review and study of  
97 depreciation rates.

98 **Q. Why was it necessary for the Company to conduct the DSR study?**

99 A. The Commission ordered the Company in Docket No. 02-035-12 to update its  
100 depreciation study within 5 years of that order. The DSR study was conducted for  
101 that express purpose. However, it is also sound accounting practice to periodically  
102 update depreciation rates to recognize additions to investment in plant assets and to  
103 reflect changes in asset characteristics, technology, salvage, removal costs, life span  
104 estimates and other factors that impact depreciation rate calculations. The Company  
105 typically conducts depreciation studies approximately at five-year intervals.

106 **Q. What conclusions has the Company reached in this proceeding?**

107 A. The Company concludes that the DSR study is well supported by the underlying  
108 engineering and accounting data and that it results in depreciation rates that are fair  
109 and reasonable.

110 **Q. Please explain the concept of depreciation.**

111 A. There are many definitions of depreciation. The following definition was put forth  
112 by the American Institute of Certified Public Accountants in its Accounting Research  
113 Bulletin #43:

114 Depreciation accounting is a system of accounting which aims to distribute

115 the cost or other basic value of tangible capital assets, less salvage (if any),  
116 over the estimated useful life of the unit (which may be a group of assets) in a  
117 systematic and rational manner. It is a process of allocation, not of valuation.

118 The actual payment for electric utility plant assets occurs in the period in which it is  
119 acquired through purchase or construction. Depreciation accounting spreads this cost  
120 over the useful life of the property. The fundamental reason for recording  
121 depreciation is to provide for accurate measurement of a utility's results of  
122 operations. Capital investments in the buildings, plant, and equipment necessary to  
123 provide electric service are essentially a prepaid expense, and annual depreciation is  
124 the part of that expense applicable to each successive accounting period over the  
125 service life of the property. Annual depreciation is an important and essential factor  
126 in informing investors and others of a company's periodic income. If it is omitted or  
127 distorted, a company's periodic income statement is distorted and would not meet  
128 required accounting and reporting standards.

129 **Q. Why is depreciation especially important to an electric utility?**

130 A. An electric utility is very capital intensive; that is, it requires a tremendous investment  
131 in generation, transmission and distribution equipment with long lives in order to  
132 provide electric service to customers. Thus, the annual depreciation of this equipment  
133 is a major item of expense to the utility. Regulated electric prices are expected to  
134 allow the utility to fully recover its operating costs, earn a fair return on its investment  
135 and equitably distribute the cost of the assets to the customers using these facilities.  
136 If depreciation rates are established at an unreasonable low or high level for  
137 ratemaking purposes, the utility will not recover its operating costs in the appropriate

138 period, which will shift either costs or benefits from current customers to future  
139 customers.

140 **Q. Do you believe that the estimated plant depreciable lives and depreciation rates**  
141 **developed in the DSR study provide the Company with a fair and equitable**  
142 **recovery of its investment in electric utility plant and equipment?**

143 A. Yes, I believe the depreciation rates developed in the DSR study produce an annual  
144 depreciation expense which is fair and reasonable for both financial reporting and  
145 ratemaking purposes.

146 **Q. What is the basis for your confidence in the DSR study?**

147 A. I believe that a good depreciation study is the product of sound analytical procedures  
148 applied to accurate, reliable accounting and engineering data. I have reviewed Mr.  
149 Roff's work in preparing the DSR study and I concur with his choice and application  
150 of analytical procedures as described in his testimony. With respect to data inputs,  
151 the estimated plant depreciable lives used in the study are those provided by the  
152 Company and explained in Mr. Mansfield's testimony. Depreciable life estimates for  
153 other types of plant and equipment are based on Mr. Roff's actuarial analysis of the  
154 data and reviewed for reasonableness by those familiar with their operation. The  
155 accounting data has also been consistently prepared. Company employees trained in  
156 depreciation techniques extracted and summarized the retirement, salvage, and  
157 removal cost data from the accounting system, and then reviewed it for completeness  
158 and accuracy before it was provided to Mr. Roff for use in this study. Because I am  
159 comfortable with both the quality of the data inputs and the professionalism of the

160 analysis, I have complete confidence in the recommendations contained in the DSR  
161 depreciation study.

162 **SIGNIFICANT ISSUES**

163 **Q. Please summarize the significant issues you've considered in the current study.**

164 A. The most significant issue considered in the current study relates to the estimated  
165 terminal removal date of generating facilities and the ultimate plans for removal or  
166 disposal of those facilities. The Company believes it is important to take into  
167 consideration significant events which have occurred in the years since the  
168 Commission's order in Docket No. 02-035-12, where the Commission approved the  
169 settlement of the last depreciation case. Those significant events which have an  
170 impact on the expected depreciable lives of the plant include but are not limited to:  
171 (1) an evaluation of the operating and maintenance history of the plants as determined  
172 by owner operational requirements; (2) an assessment of the current condition of  
173 major equipment components; and (3) capital expenditures made and anticipated to  
174 be made at the plant;

175 With these considerations, the Company has reviewed how long the steam  
176 generation facilities can be operated and it is now recommending in this study to use  
177 64 years as the depreciable life of steam generating facilities where the Company is  
178 not a minority owner. Further explanations will be included in Mr. Mansfield's  
179 testimony.

180 **Q. What are the other changes made in relationship to the steam generating**  
181 **facilities?**



182 A. In addition to modifying the depreciable lives on the steam generating facilities, Mr.  
183 Roff evaluated the estimated cost to remove these facilities. The Company currently  
184 views that it will operate these facilities as long as they are economically viable and  
185 that those customers who are benefiting from the generation of these facilities should  
186 pay for their ultimate removal. This is consistent with past Commission orders. Mr.  
187 Roff's estimate of \$50 per kW for the removal of these facilities has been included in  
188 the study. This estimate is based on current dollars and has not been inflated to the  
189 date of removal.

190 In addition to the evaluation of the removal cost, it was also determined that a  
191 significant impact between studies resulted from the replacement of old equipment  
192 and the addition of new equipment where the facility involved has an estimated  
193 depreciation terminal life. It was determined that to mitigate the intergenerational  
194 impact, nominal interim additions should be recognized. The amount used was  
195 determined by assuming that any property retirement during the estimated five years  
196 that the new depreciation rates would be in effect would be replaced by a new  
197 addition on a dollar for dollar basis. This adjustment does not recognize the inflation  
198 which has taken place between when the original equipment was installed and its  
199 replacement. It also does not include any additions for new equipment which did not  
200 previously exist.

201 **Q. What is the significant issue related to hydroelectric facilities you considered in**  
202 **this study?**

203 A. Previous studies submitted to the Commission only included removal cost for  
204 hydroelectric facilities where the Company has entered into negotiations or

205 settlements to remove those facilities. The Company believes that either it or a  
206 successor would continue to operate the other hydroelectric facilities under terms  
207 specified by the federal government. With the current change in the political  
208 environment, it has become much more probable that some of the small facilities will  
209 face challenges related to future operations and may be removed. To mitigate the  
210 intergenerational impact on customers, the Company is proposing a  
211 decommissioning reserve for hydro plants which have a definitive decommissioning  
212 agreement, as well as for small plants for which the Company has estimated some  
213 probability of being decommissioned in the next ten-year period. This reserve is not  
214 intended to cover the decommissioning or removal of any large facility.

215 **Q. What is the significant issue related to transmission and distribution facilities in**  
216 **this study?**

217 A. The major factor impacting the current study for transmission and distribution plant  
218 assets is the increase in negative net salvage for certain of those assets.

219 **Q. Please describe negative net salvage for transmission and distribution plant and**  
220 **explain why it is considered a significant item in this study.**

221 A. Let me begin by first defining the terms net salvage and negative net salvage. Net  
222 salvage refers to the salvage value of property retired less the cost of removal.  
223 Negative net salvage occurs when the cost of removal exceeds the salvage value for  
224 property retired. Annual net salvage is expressed as a percentage in the depreciation  
225 study and is calculated by dividing the net salvage amount by the retirement amounts.  
226 Mr. Roff discusses the propriety of reflecting negative net salvage in depreciation  
227 rates and the impact on depreciation rates of recognizing negative net salvage.

228 **Q. Why is more negative net salvage being incurred by the Company for**  
229 **transmission and distribution plant assets?**

230 A. Mr. Roff was provided the historical data for both removal cost and salvage to use in  
231 determining the proposed negative net salvage rates. Current history reflects removal  
232 cost returning to more normal historical levels than were seen in the 2002  
233 depreciation study.

234 **Q. What procedures does the Company use to ensure salvage and cost of removal**  
235 **for distribution plant is properly recorded in the accounting records?**

236 A. The Company uses a work order system to record capital activity including additions,  
237 retirements, removal costs and salvage. A work order is established when operating  
238 departments identify property retirement units (PRUs) being installed, removed or  
239 replaced. Actual project labor and/or contractor costs incurred to remove PRUs are  
240 directly charged to the work order and are closed to the general ledger.

241 Transmission and distribution removal projects are estimated by Company  
242 engineers using the Regional Construction Management System (RCMS). RCMS  
243 uses engineered work standards (“construction standards”) for each PRU to estimate  
244 the amount and percentage for allocating labor charges between installation and  
245 removal activities. Actual labor costs charged to the work order are allocated to the  
246 removal account and to the construction accounts based on these construction  
247 standards. Proceeds received from salvage of removed materials are credited back to  
248 the work order.

249                   The use of work orders, the RCMS system and construction standards  
250                   combine to provide a reliable and consistent process for recording salvage and cost of  
251                   removal.

252   **Q.     What is the significant issue related to mining facilities in this study?**

253   A.     It was estimated in the 2002 depreciation study that facilities related to the Deer  
254           Creek Mine would close during 2007 and not be used to access other reserves. Since  
255           that study, the Company has determined that the use of these facilities to access other  
256           reserves provides the current most economic method of doing so. The lives on these  
257           facilities have been extended to recognize the ongoing use of these facilities.

258   **EFFECTIVE DATE**

259   **Q.     What does the Company propose as the effective date for implementing the DSR**  
260           **study depreciation rates?**

261   A.     The Company's accounting system maintains depreciation rates on a calendar year  
262           basis. Therefore, the Company proposes that the new depreciation rates be made  
263           effective January 1, 2008, which is the beginning of the next calendar year following  
264           the filing of the study.

265   **RECOMMENDATIONS**

266   **Q.     Summarize your recommendations to the Commission?**

267   A.     I recommend that the Commission find the recommendations made by Mr. Roff in the  
268           DSR study regarding depreciation rates to be the proper depreciation rates for the  
269           Company and that the Commission order the Company to reflect the depreciation  
270           rates proposed in the DSR study in its accounts and records effective January 1, 2008.

271   **Q.     Does this conclude your testimony?**

272 A. Yes.