Witness CCS – 2SR

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power for Authority to Increase Its Retail Electric Utility Service Rates in Utah and for Approval of Its Proposed Electric Service Schedules and Electric Service Regulations, Consisting of a General Rate Increase of Approximately $161.2 Million Per Year, and for Approval of a New Large Load Surcharge	**)))))))))**	**Docket No. 07-035-93** **Pre-Filed Surrebuttal Testimony of Donna DeRonne For the Committee of Consumer Services**

May 23, 2008

Table of Contents

Page

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. ARE YOU THE SAME DONNA DERONNE WHO HAS PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes. On January 25, 2008 I filed direct prefiled testimony on the issue of the appropriate test year in this docket, and on April 7, 2008 I filed direct prefiled testimony on various revenue requirement issues, along with presenting the Committee of Consumer Service's (Committee) overall revenue requirement recommendation.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. My surrebuttal testimony will respond to the pre-filed rebuttal testimony of several Rocky Mountain Power (RMP or Company) witnesses on revenue requirement issues.

- I first address several contentions made in the rebuttal testimony of RMP witness Richard Walje with regards to capital investments along with the treatment of capital investments in this docket.

- I next address the rebuttal testimony of Mark Tallman with regards to the Leaning Juniper 1 wind plant operation and maintenance costs.
- I address the rebuttal testimony of Steven McDougal regarding generation overhaul costs, Powerdale decommissioning costs, expense escalations, and cash working capital.
- Finally, I address the rebuttal testimony of RMP witness Norman Ross with regards to the projected 2008 test year property tax expense.

Q. ARE YOU MODIFYING ANY OF YOUR RECOMMENDATIONS BASED ON THE REBUTTAL TESTIMONIES FILED BY RMP?

A. Yes. Based on additional information provided by the Company in its rebuttal filing with regards to generation overhaul costs, I am revising my recommended adjustment to generation overhaul expense based on more recent historical data than that used in my original recommendation. I am attaching Exhibit CCS 2.1 SR, which consists of a modification of the previous generation overhaul expense adjustment contained in my pre-filed direct testimony. This will be discussed later in this testimony.

CAPITAL INVESTMENTS

Q. IN SEVERAL PLACES THROUGHOUT HIS REBUTTAL TESTIMONY, RMP WITNESS RICHARD WALJE REFERENCES THE HIGH LEVEL

OF CAPITAL INVESTMENTS THE COMPANY IS UNDERGOING. WOULD YOU PLEASE ADDRESS THIS TESTIMONY?

A. Yes. Throughout Mr. Walje's rebuttal testimony he references the Company's level of capital investments. For example, at page 3 of his rebuttal testimony he addresses the capital budgeting and forecasting plans, indicating at line 57 that it is ". . . unwise to expect the Company to recast its entire capital plan each time there is a national fluctuation in the Dow Jones Industrial Average, unemployment rate or consumer price index, especially when such indicia contrast with local conditions that counter such trends." At page 11 of his testimony he indicates that the Company is undertaking the most significant capital investment initiative in its history. When addressing the Committee's overall recommended revenue requirement in this case, beginning at page 9, line 208 through page 10, line 215, Mr. Walje indicates that RMP has made $420 million of investments, $192 million of which is allocable to Utah, in the six-months since September 2007, which is the end of the test period in the last rate case. He indicates that the actual investments over this period of six-months would support an increase of revenue requirement of over $30 million. He goes on to indicate that the Committee's recommendations would not support the increases associated with the capital investments.

Q. IS IT ACCURATE THAT THE COMMITTEE'S RECOMMENDATIONS WOULD NOT EVEN COVER THE COST OF THE CAPITAL INVESTMENT THAT THE COMPANY HAS PUT IN PLACE TO DATE?

A. No, this is not accurate. In addition to the impact of the capital additions on the revenue requirement, the Company has also experienced revenue growth and increase in customers over this same period. There are many other factors and components within the revenue requirement that have changed and it is not appropriate to just look in isolation at the amount of capital investment made during this period. One cannot ignore the increase in revenues that also occurred.

Additionally, and of even more relevance, is the fact that the Committee did not recommend a single adjustment to the Company's proposed capital additions included in its 2008 test year. In other words, the Committee allowed the full amount of projected additions contained within the filing in this case. The Committee has not removed any investments and thus, these actual investments that have occurred in capital have been fully reflected in the Committee's position along with the additional projected investments in capital incorporated in RMP's filing. It is also worth noting that the Division did recommend a reduction in capital additions based on the actual experience through February 2008. Through February 2008 the actual additions to plant in service have been less than what was contained in the Company's filing. As a result, Division witness Matthew Croft recommended a reduction in the plant additions included in rate base for projects that were anticipated to be added between July 2007 and February 2008, reducing plant additions during that period by $144 million on a total Company basis. In its rebuttal position, RMP agreed with this adjustment recommended by Mr. Croft thereby agreeing to reduce the plant in service contained in the Company's filing. The Company did recommend some revisions to Mr. Croft's calculations, but did agree with his recommendation that those additions through February 2008 be reflected at the actual level.

Q. IS IT YOUR POSITION THAT THE COMMITTEE'S RECOMMENDED REVENUE REQUIREMENT WOULD ALLOW THE COMPANY TO FULLY RECOVER ITS CAPITAL INVESTMENT PROJECTED TO BE PLACED INTO SERVICE DURING THE 2008 TEST YEAR?

A. Yes. As indicated above, the Committee did not remove any of the projected plant additions. The Committee’s recommended revenue requirement would allow the Company the opportunity to earn the rate of return recommended by Committee Witness Daniel Lawton.

Additionally, the Company has agreed to a reduction to the plant additions in 2008 based on more recent actual information. The Committee's recommended revenue requirement allows for full recovery of those projected plant additions.

Q. ARE THERE ANY ADDITIONAL ITEMS IN MR. WALJE'S TESTIMONY YOU WISH TO COMMENT ON?

A. Yes. In his rebuttal testimony at page 4, lines 82 through 86, Mr. Walje indicates that there are external cost pressures on the Company in areas of power costs, stating that actual power costs for the first quarter of 2008 are 17% higher than the level projected in the case. There are many factors that impact power costs, including the level of sales. In CCS Data Request 31.3 the Committee referenced this statement by Mr. Walje regarding the actual power cost being 17% higher than projected for that quarter, and asked the Company to provide the actual revenues for that same period as compared to the level projected in the case. Based on that response the actual total revenues for the first quarter of 2008 were $833.318 million, while the forecasted revenues for that same quarter were $787.596 million. In other words, actual revenues for the Company were $45.722 million higher than what had been forecasted. Based on the response to the same data request, sub-part "a", during that first quarter actual net power costs were $240 million while the projected net power cost for that same quarter were $204.6 million. This demonstrates why it is important not to look at just one component of the overall revenue requirement calculation, but to also look at other factors as well.

<u>LEANING JUNIPER 1 - OPERATING AND MAINTENANCE EXPENSES</u>

Q. IN YOUR PREFILED DIRECT TESTIMONY YOU RECOMMENDED A $217,750 REDUCTION TO O&M EXPENSE TO REMOVE 25% OF THE COST ASSOCIATED WITH AN EXPIRING TWO-YEAR WARRANTY AGREEMENT ON THE LEANING JUNIPER 1 WIND PLANT. DID THE COMPANY REBUT THIS RECOMMENDATION?

A. Yes. RMP witness Mark Tallman addressed this issue beginning at page 2 of his rebuttal testimony. While agreeing that the warranty agreement does end in September 2008, he indicated that the costs covered by the warranty expense will not be ending. It is his contention that the Company can expect to incur a similar level of cost once the warranty expires. He states that the Company ". . . expects that a similar level of cost will be incurred due to unscheduled maintenance costs incurred on a post-warranty basis." He indicates that instead of having the expense associated with the warranty, the Company will incur direct costs associated with replacing or repairing defective equipment and performing unscheduled maintenance on the wind turbines.

Q. DOES MR. TALLMAN PROVIDE ANY FACTUAL EVIDENCE OR COST ESTIMATES TO SUPPORT THIS CLAIM?

A. No, he does not. He simply makes a broad, general statement that the Company anticipates a similar level of cost without any cost projection or any information regarding the cost the Company projects to incur. It is important to note that my adjustment merely removes the cost associated with an expiring warranty agreement on this unit. The Committee's recommended cost still allows for the projected operation and maintenance costs associated with the Leaning Juniper 1 wind farm. In addition to the expiring warranty agreement, the Company's adjusted 2008 test year includes costs associated with operating and maintaining the Leaning Juniper unit. According to the direct testimony of Robert Lasich in this case, at page 17, lines 383 through 386, the operation and maintenance costs associated with Leaning Juniper wind farm for the test year is approximately $3.2 million, which includes the cost of the maintenance agreement, permitting obligations, local levee tax and land easements. RMP's rebuttal filing Exhibit RMP__(SRM-1R-RR) on page 11.2.1 shows that the total incremental generation O&M expense included in the 2008 test year in the Company's filing for the Leaning Juniper wind plant is $3,660,023. While my recommended adjustment to remove a portion of the cost associated with the warranty which expires in September 2008 removes $217,750 from the Leaning Juniper O&M expense, it still allows for the remaining ongoing operation and maintenance costs and other costs associated with the facility allowing for approximately $3.4 million ongoing operating costs.

Q. HOW DO THE PROJECTED OPERATING COSTS ASSOCIATED WITH THE LEANING JUNIPER WIND PLANT COMPARE TO THE OTHER WIND PLANTS INCLUDED IN THE FILING?

A. Based on information contained in Robert Lasich's direct testimony in this case, the O&M cost per megawatt capacity for the Leaning Juniper 1 wind plant is higher on an annual basis than for any of the other wind farms contained in the Company's filing. Even after my recommended adjustment is made, the cost per megawatt of ongoing annual O&M expense would still be higher in the filing for this facility.

Q. AFTER REVIEWING MR. TALLMAN'S REBUTTAL TESTIMONY, DO YOU CONTINUE TO RECOMMEND THAT AN ADJUSTMENT BE MADE TO THE LEANING JUNIPER WIND PLANT O&M COSTS CONTAINED IN THE COMPANY'S FILING?

A. Yes. I continue to recommend my adjustment removing three months worth of the expiring warranty costs be made, reducing O&M expense by $217,750 on a total Company basis, or $92,276 on a Utah basis. The Company has provided no factual information to show that it will incur a higher level of other operation and maintenance costs once the warranty is expired. It also hasn't shown that these ongoing costs are not already covered under the other O&M expenses contained in the filing associated with this facility.

GENERATION OVERHAUL EXPENSE

Q. IN YOUR PREFILED DIRECT TESTIMONY YOU HAD RECOMMENDED AN ADJUSTMENT TO GENERATION OVERHAUL EXPENSE TO BASE THE TEST YEAR ON A NORMALIZED AVERAGE EXPENSE LEVEL. DID RMP AGREE WITH YOUR RECOMMENDATION?

A. In part. In my prefiled direct testimony I made an adjustment to reduce generation overhaul expense to a four-year average level. At the time of preparing my prefiled direct testimony I did not have all of the information on a calendar year basis as the Company had switched fiscal years during the past four-year period. As a result, I used an average of fiscal years 2004 and 2005 and calendar years 2006 and 2007 in deriving a four-year average expense level. In the rebuttal testimony of Steven McDougal, in his Exhibit RMP__(SRM-1R-RR), at page 11.3.1, the Company provided calendar year overhaul expenses for the years 2004 through 2007. In his rebuttal testimony, Mr. McDougal agreed that an adjustment is appropriate and also agreed that an adjustment could be based on a four-year average methodology, however he also recommended several revisions to my recommended adjustment.

Q. WHAT REVISIONS DID MR. MCDOUGAL MAKE TO YOUR RECOMMENDED ADJUSTMENT TO BASE THE OVERHAUL EXPENSE ON A FOUR-YEAR AVERAGE LEVEL?

A. Mr. McDougal made several modifications. First, he used calendar year 2004 through 2007 instead of a mixed fiscal year/calendar year approach. I agree it is appropriate to use calendar years in the determination. However, Mr. McDougal then escalated each of those historical years to a 2008 level, escalating some years by as much as 15.32% beyond the actual costs incurred. He then added two additional amounts for Current Creek overhaul expense and Lake Side overhaul expense. These amounts were derived by taking the budgeted overhaul costs for each of these new facilities for calendar years 2008 through 2011 and taking an average of that four-year future period. Mr. McDougal then reduced the result by $650,000 as that amount was already included in another adjustment in the filing associated with Lake Side Plant expenses. Not removing that amount would have resulted in including Lake Side Plant overhaul costs in two places within the filing.

The result of Mr. McDougal’s calculation was an average overhaul expense of $34.9 million. Based on this, Mr. McDougal has agreed that the test year overhaul expense should be reduced by $6.5 million. On a Utah basis, his recommended reduction is $2,763,736.

Q. DO YOU AGREE WITH ALL OF MR. MCDOUGAL'S RECOMMENDED REVISIONS TO YOUR OVERHAUL EXPENSE ADJUSTMENT?

A. No, I do not. I do agree that in determining the four-year average overhaul expense calendar years 2004 through 2007 should be utilized. The result would be a four-year average overhaul expense of $28,955,489. This was provided by RMP on page 11.3.2 of Exhibit RMP__(SRM-1R-RR). In my prefiled direct testimony I had originally recommended a test year overhaul expense of $28,230,000. It is this amount that I agree should be increased to $28,955,489. This new amount based on the calendar year figures is being included as an attachment to this testimony as Exhibit CCS 2.1SR. I do not agree with Mr. McDougal's remaining revisions to my recommended adjustment.

Q. WHY DO YOU DISAGREE WITH THE ADDITIONAL REVISIONS BEING PROPOSED BY MR. MCDOUGAL?

A. As was pointed out in the prefiled direct testimony, the Company's budgeted 2008 generation overhaul operation and maintenance expense is $27,687,000. This is the amount RMP projects to incur in overhaul costs for all of its units during the 2008 test year which was set by the Commission in this case. By utilizing a four-year average level as recommended in my original prefiled direct testimony and revised in this rebuttal testimony, I am allowing for overhaul expense of $28,955,489. In addition, as mentioned earlier, there is another $650,000 included in another adjustment in the Company's filing associated with overhaul expenses for the Lake Side unit. This $650,000 is in addition to the

$28.96 million I am recommending, resulting in overhaul expense being recommended by the Committee in this case of approximately $29.6 million. This is almost $2 million more than the Company has actually budgeted to incur during the test year. However, as overhauls are included in the power cost /GRID model based on a four-year average level, I am agreeing in this case that it is appropriate to reflect overhaul expense on an average basis based on the prior four years.

Basing the cost on four-year average level acknowledges the fact that these costs fluctuate from year to year, some years being higher and some years being lower than the prior years. This is also the reason why I do not recommend escalating the historical calendar year amounts to a 2008 level - these costs fluctuate over time, both upward and downward. Additionally, if the escalations are reflected as recommended by Mr. McDougal, the Company will then be receiving significantly more than the budgeted amount in 2008.

Q. WHAT ABOUT THE AMOUNTS INCLUDED BY MR. MCDOUGAL ASSOCIATED WITH THE NEW FACILITIES?

A. Cost associated with overhaul expense for the Lake Side facility is reflected elsewhere in the Company's filing. Additionally, prior to these two adjustments being added as proposed by Mr. McDougal for Current Creek and Lake Side facilities, the amount I am recommending for inclusion in the test year still exceeds the amount the Company actually budgets to incur during the test year by approximately $2 million. Thus, my recommended test year overhaul expense level is more than adequate.

Q. ARE THERE OTHER REASONS THAT IT IS APPROPRIATE TO INCLUDE OVERHAUL EXPENSE BASED ON AN AVERAGE LEVEL AS OPPOSED TO A ONE YEAR LEVEL?

A. Yes, there are. In many instance when setting base rates, one assumes those new rates will be in effect for more than a one year period. Certain costs such as overhaul expense fluctuate from year to year as demonstrated by the exhibit attached to this testimony and Mr. McDougal's page 11.3.1 of his rebuttal filing. As overhauls occur periodically and an annual level may not be reflective of a going forward level, it would be appropriate to base it on an average historical level such as the four year average I had recommended. However, the circumstances are somewhat different in the current case. The Company has already filed notification to the Commission that it intends to file another general rate case in June of this year, which is less than one month away. Thus, it is not realistic to presume that the rates going into effect in this case will be in effect for a multiple year period. Given that, it would be appropriate for the Commission to put even more weight on the actual budgeted 2008 test year level of overhaul expense. As previously indicated, the 2008 budgeted overhaul expense for RMP is $27,687,000. Where my adjustment goes above and beyond this budgeted level, the Company's proposed adjustment presented in Mr. McDougal's rebuttal testimony exceeds my recommendation by a much higher amount. Mr. McDougal's recommendation would result in overhaul expense to be included in the 2008 test year at a level of $34,918,505, or $7,230,000 more than what it actually budgets to incur in that period. Given that rates likely will not be in effect from this case for multiple years, his recommendation is clearly not appropriate.

POWERDALE DECOMMISSIONING

Q. PLEASE SUMMARIZE YOUR RECOMMENDED ADJUSTMENT TO THE POWERDALE DECOMMISSIONING COSTS CONTAINED IN YOUR PREFILED DIRECT TESTIMONY.

A. In my prefiled direct testimony, I recommended that the projected Powerdale decommissioning costs not be included as a component of rate base as the Company has not yet expended cash on the project. Consequently, it is not appropriate to earn a return on the projected future costs. I also recommended that the amortization of the decommissioning not begin until such time as the decommissioning begins and the costs are incurred. RMP is projecting the decommissioning will occur in 2010 and after.

Q. DID THE COMPANY AGREE WITH YOUR POSITION?

A. In part, but not in total. RMP witness Steven McDougal agreed that the regulatory asset for Powerdale decommissioning should not be included in rate base where it would earn a return. However, the Company did not agree that the amortization of the regulatory asset should be deferred until the decommissioning occurs. In fact, the Company shortened its proposed amortization period from that contained in its supplemental filing.

Q. WHAT DID THE COMPANY CHANGE IN ITS REBUTTAL FILING?

A. The Company revised several components of its Powerdale hydro facility adjustments contained in the Supplemental Testimony. The Company first reduced the estimated decommissioning costs from $6.6 million to $5.9 million. The Company also removed the decommissioning cost regulatory asset from rate base, as discussed above. In addition, the Company has revised its proposed amortization period from five years to three years for both the unrecovered plant costs and the decommissioning costs.

Q. WHY DID THE COMPANY CHANGE ITS POSITION WITH REGARDS TO THE AMORTIZATION PERIOD?

A. On Exhibit RMP__(SRM-1R-RR), page 11.4, the Company indicates that it is correcting the amortization of both decommissioning costs and unrecovered plant from a five-year period to a three-year period

"…consistent with the Commission order issued January 3, 2008." The exhibit is referring to the order in Docket No. 07-035-14 in which the Commission allowed the Company's requested regulatory assets for the Powerdale plant and "…set a tentative three-year amortization period, beginning January 1, 2007." While indicating the tentative three-year amortization period, the Commission made it clear in the order that it was not resolving the specific disputes with the Powerdale Plant and indicted the amortization period was "tentative."

In the Company's supplemental filing in this case, in Exhibit RMP__(SRM-1S), the Company updated its filing for both the Commission approved 2008 test year and to reflect the Commission's decision in the Accounting Order case, Docket No. 07-035-14. In that supplemental filing, the Company reflected a five-year amortization period. The Company's change in position to the proposed three-year period for both unrecovered plant costs and decommissioning costs is not in rebuttal to any party's recommendations, but rather it is a change in position from the five-year amortization period included in its supplemental filing. There was no testimony presented in the rebuttal testimony identifying why a three-year period would be superior to the five-year period used by the Company in its original and supplemental filings.

Q. AFTER REVIEWING THE COMPANY'S REBUTTAL TESTIMONY, DO YOU CONTINUE TO RECOMMEND THAT AMORTIZATION OF THE DECOMMISSIONING COSTS BE DEFERRED UNTIL THE COSTS ARE INCURRED?

A. Yes, I do, for the reasons cited in my prefiled direct testimony. The fact remains that the decommissioning will not occur until 2010 or thereafter. I continue to recommend that the amortization of the decommissioning costs not be reflected in rates in this docket.

Q. GIVEN THAT THE COMPANY HAS INDICATED THAT ONLY $2.5 MILLION OF THE PROJECTED DECOMMISSIONING COSTS WERE RECORDED IN THE REGULATORY ASSET ACCOUNT WITH THE REMAINING COSTS RECORDED IN AN ACCOUNT THAT IS ASSIGNED A NONUTILITY ALLOCATION FACTOR, SHOULD YOUR REDUCTION TO RATE BASE TO REMOVE THE DECOMMISSIONING REGULATORY ASSET BE REDUCED?

A. Possibly. In my direct testimony, I presumed the Company had recorded the full projected decommissioning costs as a regulatory asset consistent with its accounting request. Thus, I reduced rate base by the full $5,974,107 to remove the average unamortized balance. If, in fact, only $2.5 million was recorded in the regulatory asset account by the Company, then my adjustment should be reduced to remove that amount.

.

Q. IF THE COMMISSION ADOPTS THE COMPANY'S RECOMMENDED POSITION WITH REGARDS TO THE AMORTIZATION OF THE PROJECTED POWERDALE DECOMMISSIONING COSTS, SHOULD ANY FURTHER ADJUSTMENTS BE MADE?

A. Yes. If the Company is permitted to begin amortization of the future Powerdale decommissioning costs in this case, then it will be collecting the costs from ratepayers prior to actually incurring the costs. This would result in a cost-free source of capital to the Company which should be used to offset rate base. Thus, if RMP is allowed the amortization, rate base should be offset by the average test year balance collected from customers. If the Commission approves the three-year amortization period recommended by the Company, the annual amortization expense for the decommissioning would be $1,983,317 and rate base should be offset by 50% of this amount, or $991,659 to recognize the average test year balance of the funds being pre-collected from ratepayers.

<u>ESCALATION</u>

Q. IN HIS REBUTTAL TESTIMONY, MR. MCDOUGAL CONTENDS THAT YOUR ADJUSTMENT TO REDUCE ESCALATION FACTORS RELIES ON FAULTY LOGIC AND DOUBLE COUNTS SAVINGS. DO YOU AGREE WITH HIS CONTENTION?

A. No, I do not. In my adjustment, I revised the escalation factors proposed by RMP downward to allow for a 1.25% inflationary increase. As indicated in my prefiled direct testimony, the Company does not project that overall costs between 2007 and 2008 will increase at a level consistent with inflation and that labor savings and productivity will offset inflationary pressures. As the Company's historical test year is a mix of 2006 and 2007, ending June 30, 2007, I recommended costs be increased by 1.25% to allow for an additional half a year of inflation to bring costs closer in line with a 2007 level.

Q. DOES YOUR ADJUSTMENT EFFECTIVELY LIMIT THE COST INCREASES TO 1.25% ABOVE THE TEST YEAR LEVEL?

A. No, it does not. Consistent with how the Company applied its non-labor escalation adjustment, my adjustment to reduce escalation to 1.25% is being applied to the same non-labor costs. Labor is a significant component of the O&M costs. The Committee is allowing for the projected labor escalations requested by the Company, which exceed 1.25% annually. Additionally, the Company's filing includes various adjustments increasing test year expenses for items such as the incremental generation O&M associated with the new generation facilities. These are incremental to the O&M escalation adjustment. My adjustment to the non-labor O&M escalation is not removing costs contained within the historical test period, rather it is reducing the increase in these costs reflected by the

Company in its filing to a lower level, but still allowing for an increase in these costs. Admittedly the increase is not as high as that reflected by the Company in its calculations, but it is an increase to these specific non-labor and non-power costs nonetheless.

Q. MR. MCDOUGAL INDICATES THAT SAVINGS AND EFFICIENCIES ARE REFLECTED IN THE FILING OFFSETTING THE ESCALATION INCREASE. ARE THERE ANY ADJUSTMENTS THAT ALSO REFLECT COST INCREASES?

A. Yes. While Mr. McDougal is correct that the filing reflects cost savings or efficiencies associated with the automated meter reading (AMR) program and transition savings, there are also increases in costs reflected such as the incremental generation O&M adjustment and general wage escalation increases. Additionally, part of the transition savings adjustment is removing non-recurring one-time costs associated with severance payments, most of which occurred in 2006.

Q. BASED ON MR. MCDOUGAL'S REBUTTAL TESTIMONY, ARE YOU REVISING YOUR ESCALATION ADJUSTMENT?

A. No, I am not.

<u>CASH WORKING CAPITAL – INTEREST EXPENSE</u>

Q. MR. MCDOUGAL, BEGINNING AT PAGE 42 OF HIS REBUTTAL TESTIMONY, ADDRESSES CASH WORKING CAPITAL. WOULD YOU PLEASE DISCUSS HIS TESTIMONY?

A. Yes. Beginning at page 42, Mr. McDougal first provides a description of cash working capital and a lead/lag study followed by the identification of what RMP included in its case for cash working capital. Overall, I agree that his definition of the nature of cash working capital is an accurate description. He defines cash working capital as "…a rate base component that measures the amount of cash that a utility's investors are required to advance to fund the utility's day-to-day operations." He also correctly indicates that "cash working capital can be either positive or negative, depending upon whether the revenue lag exceeds the expense lead." Of utmost importance in evaluating a cash working capital component to include in rate base is to consider that the purpose of including cash working capital is that it measures the amount of cash required to fund the utility's day-to-day operations. This can either be funds supplied by investors upon which a return should be given if there is a positive cash working capital requirement, or a reduction to rate base if, in fact, the day-to-day operations are being funded by ratepayers in situations in which the revenues are collected from customers prior to expenses being paid.

Q. IN YOUR PREFILED DIRECT TESTIMONY, YOU RECOMMENDED THAT CASH WORKING CAPITAL BE ADJUSTED TO INCLUDE THE IMPACT OF INTEREST EXPENSE ON LONG TERM DEBT. COULD YOU PLEASE BRIEFLY SUMMARIZE THIS RECOMMENDATION?

A. In my prefiled direct testimony, I recommended that cash working capital be adjusted to include the impact of interest expense on long term debt. The costs to pay the interest expense on the long term debt is collected by the Company in the revenues that are generated. This revenue lag is utilized in deriving the net lead/lag days applied by the Company. The interest that is being collected as part of those revenues is not paid out until some time after the revenues are received. This results in additional cash being available to the Company for funding its day-to-day operations. The revenue is an actual cash receipt and the interest expense is an actual cash payment which occurs some time after the cash is received to fund the payments. One should not ignore this cash that is available to fund the day-to-day operations of the Company.

Q. DID THE COMPANY AGREE WITH THIS RECOMMENDATION?

A. No, it did not. Mr. McDougal disagreed with my recommendation beginning at page 44 of his rebuttal testimony, indicating that it is a "…well-worn notion that is given little credence by recognized authorities in the field of utility accounting." I disagree. He then continues with his rebuttal, citing from <u>Accounting for Public Utilities</u> by Robert L. Hahne.

While I have seen several utilities cite Mr. Hahne’s book in cases, I would like to note that many do not consider Mr. Hahne to be unbiased and that he has often represented utility interests in proceedings.

In referencing Mr. Hahne’s text book, Mr. McDougal states that Mr. Hahne “…indicates that the most prevalent approach is to not consider the operating income component in the lead/lag study and to not recognize accruals of interest as source of cash working capital.” However, operating income is, in fact, considered when preparing a lead/lag study in the revenue lag determination. The operating income is part of what is being recovered in the revenue lag. Included in utility revenues are the recovery of operating costs, operating income and an interest component, among other items. The revenue lag is one of the main components in determining the net lead/lag days. Thus, the lag in receiving the operating income, or revenues, is acknowledged in the derivation of the revenue lag days. There is no inconsistency in also acknowledging that the Company is receiving revenues, which include the recovery of interest costs, well in advance of actually paying the interest expense. One should not look at the form over the facts. The fact is that interest is being recovered by the Company in rates prior to the cash actually being paid out to the lenders, resulting in cash available to fund the day-to-day operations of the utility.

Q. MR. MCDOUGAL INDICATES THAT THE UTAH COMMISSION HAS SPECIFICALLY REJECTED THE INCLUSION OF AN INTEREST COMPONENT IN THE CASH WORKING CAPITAL CALCUALTIONS. WOULD YOU PLEASE ADDRESS THIS ISSUE?

A. Yes. Mr. McDougal first cites a case from the 1980s, Docket No. 82-035-13, in which the Commission indicated that "…non-cash items should not be components of working capital because they do not represent additional uncompensated investments." I would strongly agree that non-cash items should not be included as components of working capital. However, interest expense is not a non-cash item. It is an item that is paid out to lenders in the form of cash.

Mr. McDougal then cites a Mountain Fuel case in Docket No. 93-057-01, in which the Commission stated the following:

> In Docket No. 82-035-13 we adopted a method for determining cash working capital that excludes consideration of depreciation, interest expenses, and preferred and common dividends. That method has been affirmed in recent Commission orders and applies to PacifiCorp and U.S. West as well as to Mountain Fuel. If this method is to be changed, a strong burden of persuasion will first have to be met which must include a comprehensive analysis of all four of the above-mentioned items. Lacking such an analysis in this docket we reject the Committee's recommendation to include interest expense and preferred dividends in the calculation of cash working capital.

Q. GIVEN THE UTAH COMMISSION ORDERS CITED BY MR. MCDOUGAL, ARE YOU CHANGING YOUR POSITION?

A. No, his testimony does not change the fact that interest expense is a cash item and the fact that the Company collects the funds from ratepayers which include the recovery of interest prior to the actual cash expenditure for the interest being made. I do, however, acknowledge that the Utah Commission has specifically excluded this item in the past. I recommend that this issue be reconsidered by the Commission as it is an actual cash item that is available to the Company towards funding the day-to-day operations.

Q. ARE YOU AWARE OF OTHER JURISDICTIONS IN WHICH INTEREST EXPENSE HAS BEEN INCLUDED AS A COMPONENT OF A LEAD/LAG STUDY?

A. Yes. I have seen interest included by utilities in its lead/lag studies in jurisdictions in which the lead/lag study approach is used in determining the cash working capital component of rate base.[1]

PROPERTY TAXES

Q. IN YOUR DIRECT TESTIMONY YOU RECOMMENDED THAT THE 2008 TEST YEAR PROPERTY TAX EXPENSE BE REDUCED FROM THE COMPANY'S FORECAST AMOUNT OF $82.4 MILLION TO

---

[1] Examples of jurisdictions in which interest expense has been included in the cash working capital calculations under the lead/lag study approach include cases before the Arizona Corporation Commission, Connecticut Department of Public Utility Control, and the District of Columbia.

$70,736,062, A REDUCTION OF $11,662,989 FROM THE AMOUNT INCLUDED IN THE FILING ON A TOTAL COMPANY BASIS. DID THE COMPANY ADDRESS YOUR RECOMMENDATION IN ITS REBUTTAL TESTIMONY?

A. Yes. My recommendation was addressed in the rebuttal testimony of RMP witness Norman Ross. In his rebuttal testimony, the Company agreed to reduce its projected 2008 property tax expense by $2.7 million on a total Company basis, resulting in a projected 2008 property tax expense of $79,665,746 on a total Company basis. This is an increase of 14.9% above the historical test year level. Mr. Ross recommends that my recommended adjustment, which would reduce the projected 2008 property tax expense to $70,736,062, be denied.

Q. AFTER REVIEWING MR. ROSS' REBUTTAL TESTIMONY, DO YOU STILL FEEL YOUR ADJUSTMENT IS APPROPRIATE AND REFLECTIVE OF 2008 COST LEVELS?

A. I am still strongly recommending that the adjustment reflected in my direct testimony be adopted by the Commission. As indicated in my testimony, the property tax expense incurred by the Company has fluctuated from year to year, with the cost declining in several years and increasing slightly in several years. Presented below is the actual total Company tax expense along with the annual percentage change in that expense for each year 2003 through 2007:

2003 Property Tax Expense	67,067,823	
2004 Property Tax Expense	65,005,807	-3.07%
2005 Property Tax Expense	64,942,799	-0.10%
2006 Property Tax Expense	67,506,520	3.95%
2007 Property Tax Expense	69,102,427	2.36%

This table was presented in my initial direct testimony at page 33 beginning at line 728. As can clearly been seen from this table, from the period 2003 through 2007, property tax expenses have fluctuated from declining by 3.07% between 2003 to 2004 to increasing by 3.95% between 2005 and 2006. If one looks over that entire five-year period from 2003 through 2007, property tax expense increased by only $2,034,604 or 3.03% over that entire five-year period. This is during a period of rapid investment and increasing net operating income for the Company. It is not realistic for the Company to now assume that from 2007 to 2008 its property tax expense will increase by almost 15%. This is a huge increase that is projected in a one-year period, particularly when looking at the actual property tax expense levels over the last five years.

Q. MR. ROSS, AT PAGE 3 OF HIS TESTIMONY, AT LINES 57 THROUGH 62, ADDRESSES YOUR ASSERTION THAT THE COMPANY'S PROJECTED PROPERTY TAX EXPENSES ARE OUT OF LINE WITH HISTORICAL LEVELS. HE INDICATES THAT "WHILE THE PROJECTED INCREASE IN PROPERTY TAX EXPENSE FOR THIS CASE IS SIGNIFICANT, THE INCREASE IS DRIVEN BY A CORRESPONDINGLY SIGNIFICANT INCREASE IN THE LEVEL OF

PROPERTY SUBJECT TO ASSESSMENT AND IN THE LEVEL OF EARNINGS THAT TAXING JURISDICTIONS RELY UPON WHEN ESTIMATING THE VALUE OF THE COMPANY'S PROPERTY." WOULD YOU PLEASE ADDRESS THIS ASSERTION?

A. Yes. What one must also realize is that during this same period that I have reflected in the five year analysis presented above, the Company also had significant increases in the level of property subject to assessments and also had a significant increase in earnings during that same period. During that five-year period the Company was in frequently for rate increases at many of its jurisdictions. Both revenue and plant in service have grown substantially over that five years, yet property taxes have only increased by 3%. Mr. Ross has presented nothing compelling to demonstrate that suddenly there will be a 15% increase in property tax expenses going into 2008.

Q. AT PAGE 5 OF HIS REBUTTAL TESTIMONY, MR. ROSS PRESENTS A TABLE SHOWING THE INCREASES IN NET UTILITY PLANT, MATERIALS AND SUPPLIES, FUEL, PROPERTY SUBJECT TO ASSESSMENT AND NET UTILITY OPERATING INCOME OVER THE PERIOD 2002 THROUGH 2007. PLEASE ADDRESS THIS TABLE PRESENTED IN HIS TESTIMONY.

A. His table shows the property subject to assessment and net utility operating income each year for the period 2002 through 2007. At the bottom of his table he provides the increase in each of these items above December 2002 amounts along with the percentage increase. He shows that property subject to assessment has increased by 38% between the years 2002 and 2007 and that net utility operating income has increased by 45% over that same period. He then states at page 6 of his testimony, beginning at line 106, that "Despite the fact that property subject to assessment has climbed by 38% and net operating earnings by 45% since 2002 with most of the increase occurring in the past two years, witness DeRonne proposes a level of property tax expense that is only 5.5 percent . . . higher than in 2003." While I am not disputing the percentage increase in property subject to assessment or in net operating earnings presented in his table, it is very important that another factor be significantly considered when looking at this table and his analysis. Below I provide an update to his table that includes all of the exact amounts presented within his analysis, but adds one additional column. This additional column presents the actual property tax expense recorded by the Company for each of the years 2003 through 2007. As shown on that table, between 2003 through 2007 actual property tax expenses only increased by 3%.

	Net Utility Plant	Materials & Supplies	Fuel	Property Subject to Assessment	Net Utility Operating Income	Property Tax Expense *
YE 12/31/02	7,896,903,614	92,508,235	69,561,552	8,058,973,401	479,675,695	
YE 12/31/03	8,120,324,805	91,550,850	53,546,693	8,265,422,348	465,716,559	67,067,823
YE 12/31/04	8,450,786,258	105,246,617	48,450,942	8,604,483,817	459,091,927	65,005,807
YE 12/31/05	8,997,534,918	117,959,772	56,631,067	9,172,125,757	519,453,886	64,942,799
YE 12/31/06	9,852,669,038	129,731,866	82,230,862	10,064,631,766	580,803,409	67,506,520
YE 12/31/07	10,887,535,383	150,050,022	98,334,182	11,135,919,587	694,791,749	69,102,427
Increases over December 31, 2002 Amounts				3,076,946,186	215,116,054	2,034,604
% Increase over December 31, 2002 Amount				38%	45%	3%

* For Property Tax Expense Column, Amount and % increase from December 31, 2003 Amounts

Clearly, based on this one should not only consider the percentage increase in property subject to assessment and net operating earnings increase as Mr. Ross would suggest. It is also important to consider what has actually occurred with the property tax expense incurred by the Company rather than two of the many components that go into factoring and calculating the actual property tax expense charged by the taxing authorities. While the items presented by Mr. Ross in his schedule do impact property tax expense, there are many other factors that impact the actual property tax expenses and assessments charged by the various taxing authorities.

Q. IN YOUR DIRECT TESTIMONY, BEGINNING AT PAGE 33, LINES 731 THROUGH PAGE 34, LINE 745, YOU ADDRESS THE INACCURACY IN THE PROPERTY TAX FORECAST INCLUDED IN PRIOR COMPANY RATE CASES. DID MR. ROSS ADDRESS THE PROBLEMS YOU RAISED WITH THE COMPANY'S PRIOR FORECASTS?

A. No, he did not. As indicated in my prefiled direct testimony, in Docket No. 04-035-42, the Company utilized a projected test year ending March 31, 2006 and included a projected property tax expense for that period of $71.66 million. The actual property tax expense for the 12 months ended December 31, 2005 and December 31, 2006 was $64.9 million and $67.5 million, respectively. Clearly, the Company significantly over estimated the property tax expense in that docket. Additionally, in Docket No. 06-035-21 the Company utilized a projected test year ending September 31, 2007 in which it projected property tax expense of $75 million. The actual property tax expense for the 12 months ended December 31, 2007 was only $69.1 million. The Company also over projected significantly the level of property tax expense in that docket. The Company's rebuttal testimony in this case did not address these significant prior over projections of property tax expense in its past cases.

Q. DOES THIS COMPLETE YOUR PREFILED SURREBUTTAL TESTIMONY?

A. Yes.