This Document Discussed How Net Salvage Treatment proposed by PacifiCorp Includes Future Inflation.

The method PacifiCorp uses builds decades of inflation into the Net Salvage factor. When that factor is applied to newer investments, it produces a Net Salvage estimate that has decades of future inflation built into it.

Discussing the method PacifiCorp used, a standard depreciation textbooks states:

> "One inherent characteristic of the salvage ratio is that the numerator and denominator are measured in different units; the numerator is measured in dollars at the time of retirement, while the denominator is measured in dollars at the time of installation." (Emphasis added) [1]

When PacifiCorp uses this method to estimate the net salvage for a future retirement, the "time of retirement" is in the future, and that net salvage is "measured in dollars at the time of retirement," which are future dollars.

The treatment PacifiCorp uses estimates future salvage by effectively assuming that future inflation will be equal to past inflation. The historic percents are calculated in a way that inflates the historic percents for past inflation. When a similar percent is applied in the current study to estimate future net salvage, the historic inflation that is built into the historic percent is projected into the future. This calculates the future net salvage in inflated future dollars.

Page III-631 of Company Depreciation Study shows the Summary of Book Salvage for Account 356, Overhead Conductors and Devices.

[1] Page 53 of *Depreciation Systems* by Frank K. Wolf and W. Chester Fitch, 1994, Iowa State University Press.

The "2011" line shows the Cost of Removal amount of $1,385,168. This amount is in Year-2011 dollars, since it occurred in the year 2011.

The amounts in the "Regular Retirement" column are the Original Cost amounts of the investment that retired in the year 2011. The Original Cost amounts are stated in the dollars as of the year they were installed. For example, of the $4,594,416 in the "Regular Retirement" column on the "2011" line, the largest amount include in that figure is the $961,981 retirement of investments installed in the year 1982.[2] That $961,981 Original Cost is stated in year-1982 dollars, since that is when those Original Cost amounts were recorded.

The 30% in the Cost of Removal, Percent Column is calculated by the $1,385,168 Cost of Removal amount (which is in year-2011 dollars) divided by the $4,594,416 "Regular Retirement" amount (which is in past dollars. For example, it includes $961,981 that is in 1982 dollars). Since the Cost of Removal is in 2011 dollars, but the Original Cost is in dollars decades before that, the percent includes inflation. For example if the average is two decades between the time the plant was installed and the Cost of Removal, that 30% figure will be the inflated Cost of Removal including the inflation for two decades after the plant is installed.[3] When calculating the future Cost of Removal, if the 30% factor is applied to investment that was recently installed, that 30% factor provides the inflated Cost of Removal including the inflation two decades after the plant is installed. For example, if the 30% factor is applied to investments installed in the year 2010, that 30% factor will produce the estimated Cost of Removal including

[2] Data from PacifiCorp response to DPU Data Request 2.2 Attachment 1.
[3] This is a simplification, because the dispersion would have an impact, but this does properly demonstrate the principle. I do include the impact of dispersion in my actual calculation.

two decades after the 2010 year of installation, which is including future inflation to the year 2030.[4]

The method PacifiCorp uses builds decades of inflation into the factor. When that factor is applied to current investments, it produces a Cost of Removal estimate that has decades of future inflation built into it.

[4] This is a simplification, because the dispersion would have an impact, but this does properly demonstrate the principle. I do include the impact of dispersion in my actual calculation.