1 Q. Please state your name and business address.

2 A. My name is Jeffrey K. Larsen. My business address is, One Utah Center, Suite 2000,
3 201 South Main Street, Salt Lake City, Utah, 84140-2000.

4 **Qualifications**

5 Q. What is your current position at PacifiCorp d.b.a. Utah Power and Light ("Company")
6 and your previous employment history with the Company?

7 A. I am currently employed as the Revenue Requirement Director in the Regulation
8 Department. I joined the Company in 1985, and I have held various accounting and
9 regulatory related positions prior to my current position.

10 Q. What are your responsibilities as the Director of Revenue Requirement?

11 A. My primary responsibilities include the calculation, justification and reporting of
12 regulated earnings, interjurisdictional cost allocations, and communications with
13 regulators on jurisdictional embedded cost-related issues in the six jurisdictions in
14 which the Company provides retail electric services.

15 Q. What is your educational background?

16 A. I received a Master of Business Administration Degree from Utah State University in
17 1994 and a Bachelor of Science Degree in Accounting from Brigham Young
18 University in 1985. In addition to formal education, I have also attended various
19 educational, professional and electric industry related seminars during my career at
20 the Company.

21 **Purpose of Testimony**

22 Q. What is the purpose of your testimony in this proceeding?

1 A. My testimony presents evidence that, based on its normalized 1998 results of
2 operations, PacifiCorp is earning an overall return on equity (ROE) in its Utah service
3 territory of 7.82%. This return is less than the ROE currently authorized by the Utah
4 Public Service Commission (Commission) and less than that required to provide a fair
5 and equitable return for the Company's shareholders. In support of this conclusion, I
6 introduce and describe the Company's Utah Results of Operations Report for the 12
7 months ended December 31, 1998. In describing the 1998 results of operations, I
8 indicate the sources of the base data and describe appropriate normalizing
9 adjustments.

10 **Results of Operations**

11 Q. I show you what has been marked as UPL Exhibit UP&L __.1 (JKL-1) and ask if you
12 can identify it?
13 A. Yes. UPL Exhibit UP&L __.1 (JKL-1) is the Company's Utah Results of Operations
14 Report for the 12-month test period ended December 31, 1998. I will hereafter refer
15 to this exhibit as the "results" or the "report".
16 Q. Was the report prepared under your direction?
17 A. Yes.
18 Q. Please describe the contents of this report.
19 A. The results of operations report details revenues, expenses and rate base assigned to
20 the Company's Utah service territory using a rolled-in allocation method. The report
21 provides 12-month totals for revenues and expenses and expresses rate base as the
22 average of beginning and end-of-year balances. Operating results for the period are
23 presented in terms of both return on rate base and return on equity. The results begin

1 on page 1.0 with a summary of the normalizing adjustments to actual 1998 results.
2 The unadjusted results (Column 1) are a product of allocation factors derived from
3 weather-normalized loads. Column 2 combines and summarizes the effect of Type 1
4 Adjustments (normalization for out-of-period adjustments and unusual items that
5 occur during the test period) and Type 2 Adjustments (annualization of changes that
6 occurred during the test period) to produce "total adjusted actual results" (Column 3).
7 Column 4 summarizes Type 3 Adjustments (known and measurable items that will
8 occur in a future test period) that are necessary to reach the "total adjusted results" in
9 Column 5. The only Type 3 adjustments included in the report reflect costs charged
10 in 1999 for employees who qualified under the 1998 early retirement program but did
11 not separate from the Company until 1999, and the associated impacts of this
12 adjustment on interest synchronization and working capital. Column 6 shows the
13 increase in Utah revenues that would be required for the Company to earn a 11.25%
14 return on equity from its Utah operations. Column 7 reflects the total adjusted results
15 with this revenue increase included. For comparison purposes, page 1.0 reflects
16 returns on rate base and equity for both the unadjusted and normalized results.
17 The unadjusted results allocated to Utah using a rolled-in allocation method
18 are detailed under Tab 2. Supporting documentation for the data in Tab 2 is provided
19 under Tabs B1 through B20. The total column of the unadjusted results on page 2.2
20 corresponds to the actual data recorded in the Company's accounting records. The
21 normalizing adjustments, which are required to smooth the impact of any unusual
22 events which may have occurred during the test period, are identified on pages 1.1

through 1.4 and further documented under Tabs 3-9. The calculation of the rolled-in allocation factors is described under Tab 10.

Q. What conclusions do you draw from the results of operations summary presented on page 2.2?

A. I observe that, as detailed in Column 6 of page 1.0, an overall price increase of $67 million (9.9%) would be required to increase the Company's earned ROE to 11.25% as recommended by Samuel C. Hadaway.

Development of Base Data (Unadjusted Results)

Q. Please explain the process for compiling the base data used in the results.

A. The revenue, expense and rate base data which comprise the unadjusted results of operations is extracted directly from the Company's accounting system and has been summarized under Tabs B1 through B20. The extraction process is largely a matter of downloading information from computer files, supplemented by manual inputs.

Q. Does the unadjusted base data fairly represent the Company's results of operations for 1998?

A. The base data reflects the operating environment and the unique set of circumstances that occurred during calendar year 1998. It is a fair depiction of 1998 actual results, but it is entirely inadequate as a predictor of on-going Company performance. To adequately reflect results on a going-forward basis, it is necessary to make certain adjustments to reflect normal conditions. These adjustments annualize specific events in the test period or normalize unusual events. The following section uses the term "normalizing adjustment" in a generic sense to refer to both annualization of in-period events and normalization of unusual events.

1 **Normalizing Adjustments**

2 Q. Please describe what you mean by normalizing adjustments.

3 A. In reporting its results of operations, it is the Company's goal to develop a "typical"
4 test period, free from effects of unusual events. Normalization adjusts for the impact
5 of unusual, non-recurring events. The 1998 Commission-ordered rate refund is an
6 example of this type of unusual impact. As I indicated earlier, adjustments for out of
7 period events and unusual items that occurred during the test period are categorized as
8 Type 1 Adjustments in the results of operations report. Normalization also requires
9 an adjustment for the effect of changes that occur part way through the test period.
10 For example, a wage increase that takes place in March should be adjusted to reflect a
11 full 12-month impact. This type of adjustment is also known as annualization and is
12 referred to as a Type 2 Adjustment in the report.

13 Normalizing adjustments need not be restricted to events that occurred within
14 the test period. PacifiCorp believes that to most effectively match prices with
15 anticipated conditions in the rate-effective period, it is necessary to reflect significant
16 known and measurable out-of-period adjustments in the ratemaking process.
17 However, to be in compliance with Utah test period guidelines, the Company has
18 made only one such adjustment to its 1998 results of operations. That adjustment
19 matches costs and benefits realized in 1999 for employees who qualified under the
20 1998 early retirement program but did not separate from the Company until 1999.
21 The related calculations of interest synchronization and working capital associated
22 with this adjustment have also been included. The inclusion of the 1999 early

1 retirement costs and benefits is referred to as a Type 3 adjustment in the results of
2 operations report.
3 Q. Is the inclusion in the 1998 test period of early retirement costs and benefits realized
4 in 1999 consistent with previous Commission orders?
5 A. Yes. In Docket No. 97-035-01 the Commission ordered that costs associated with
6 computer mainframe hardware and software write-downs be removed from the test
7 period because the associated benefits were yet to be realized. The Commission
8 found that including these write-downs would result in a mismatch of costs and
9 benefits and would inappropriately inflate test-year costs. In this proceeding, the
10 Company's adjustment to reflect the early retirement program maintains an
11 appropriate match between program costs and program savings because 1998 program
12 costs are matched with 1998 savings and post-1998 program costs are matched with
13 post-1998 program savings. Therefore, inclusion of 1999 early retirement costs in the
14 1998 test year is consistent with prior Commission orders that require an appropriate
15 matching of costs and benefits.
16 Q. Would you explain each of the 1998 normalizing adjustments?
17 A. Yes. The report detail under Tabs 3 through 10 supports the summary sheets on
18 pages 1.1 through 1.4 and the normalized returns on page 1.0. Considerable
19 description for each of the adjustments is provided within the exhibit; however, I
20 believe it will be useful to review these explanations at this point in my testimony. In
21 order to understand why the Company believes that the normalized returns on rate
22 base and equity that have been developed are reasonable predictors of future
23 performance, it is necessary to understand the reasons for the underlying adjustments.

1 I will discuss the adjustments in the order in which they are presented in Tabs 3
2 through 9, i.e., revenue, O&M, net power costs, depreciation and amortization, taxes,
3 and rate base. For discussion purposes the adjustments will be presented in pre-tax
4 dollars, where applicable. The income tax effect of each adjustment is calculated and
5 reflected on the summary page following each tab.

6 Q. Please explain the revenue adjustments summarized under Tab 3, page 3.0.

7 A. **Weather Normalization** (Adjustment 3.1) – Adjustment 3.1 normalizes revenues in
8 the test period by comparing actual loads to temperature-normalized loads in the
9 manner approved by the Commission in Docket No. 97-035-01. Weather
10 normalization reflects weather or temperature patterns that were measurably different
11 than normal, as defined by 30-year historical studies by the National Oceanic &
12 Atmospheric Administration. Only residential and commercial sales are considered
13 weather sensitive. Industrial sales are more sensitive to specific economic factors.
14 Costs have been normalized through adjustments to loads used to develop allocation
15 factors and net power costs. This adjustment increases 1998 Utah residential
16 revenues by $488,460 and decreases commercial revenues by $370,743.

17 **Effective Price Change** (Adjustment 3.2) – The price change adjustment annualizes,
18 in accordance with Commission annualization rules, existing contracts and tariff
19 changes to reflect a full year of revenues based on the new rates. The annualization is
20 done by comparing actual revenues in the test period to the annualized revenues
21 calculated by applying the new rates in the contracts and tariffs to current energy
22 usage. By far the largest component of this adjustment is the inclusion of 12 months

of the price reduction ordered in Docket 97-035-01. Adjustment 3.2 results in a net decrease of $88,013,966 in Utah test period revenues.

Revenue Normalizing (Adjustment 3.3) – This adjustment normalizes 1998 revenues by removing out of period adjustments. By far the largest component of this adjustment is the removal of the effect of the rate refund ordered in Docket 97-035-01. Adjustment 3.3 increases Utah situs revenues by $37,392,120, increases Utah's allocated share of revenues from system contracts by $1,155,005 and appropriately reflects deferred income tax effects.

SO2 Emission Allowances (Adjustment 3.4) – The significant gains realized by the Company from the sale of emission allowances in recent years need to be normalized down to a level more reflective of future ongoing operations. Adjustment 3.4 achieves this normalization by applying the 4-year amortization approach contained in the stipulation dated October 8, 1998 that was approved by the Commission in Docket 97-35-01. The adjustment removes the actual gain from allowances sold in 1998 ($11.5 million) from the test period and replaces it with a 4-year amortization of the actual gains from both 1997 and 1998. The second year of the 1997 amortization adds $5.1 million of revenue to the test period and the first year of the 1998 amortization provides an additional $2.9 million.

The net effect of Adjustment 3.4 is to reduce the total 1998 gain from the sale of SO2 emission allowances by $3.5 million and reduce Utah's allocated share of this amount $1,206,527. This adjustment also reduces Utah rate base by the $5,236,643 to reflect the balance of the unamortized gain, and records the associated deferred tax impacts.

1 **USBR/UKRB Discount** (Adjustment 3.5) – Under existing contracts with
2 PacifiCorp, the U.S. Bureau of Reclamation (USBR) and the Klamath Basin Water
3 Users' Protective Association (UKRB) receive a reduced price compared to fully
4 tariffed customers. The contracts preserve the Company's interests in three hydro
5 projects on the Klamath River. The reduced irrigation revenues have been treated as
6 situs revenues of Oregon and California. However, since all customers share in the
7 benefits of the hydro production from these plants, it is appropriate that the costs be
8 shared in the same way. This adjustment, which was approved by the Commission in
9 Docket No. 97-035-01, treats the discount as a cost of PacifiCorp's entire hydro
10 system rather than as a state specific cost, thereby increasing Utah's allocated share of
11 hydro expense by $1,867,034.
12 **Pilot Revenue** (Adjustment 3.6) – During 1998, the Company received revenues for
13 sales of energy into the pilot customer choice programs of both Puget Power in
14 Washington and Portland General Electric in Oregon. This adjustment reassigns
15 those revenues from Washington and Oregon to a system-wide allocation, thereby
16 increasing Utah revenues by $3,859,434.
17 **Tariff 300 Revenues – Utah** (Adjustment 3.7) – In Docket 97-035-01, the
18 Commission authorized changes to Schedule No. 300 customer charges. These
19 changes relate to interest on customer service deposits, interest charged on late
20 payments, returned check charges and other miscellaneous service fees. The change
21 in interest on customer deposits is reflected in Adjustment 4.13. The interest rate the
22 Company is authorized to charge on past due accounts was reduced from 1.5% to 1%
23 per month, and the returned check charge was increased from $4 to $15 dollars.

1 Changes in miscellaneous service fees include: increasing copy fees from $1 to $2 per
2 page, increasing the temporary service connection fee from $45 to $85, adding a $20
3 charge for service calls and discontinuing the rental of temporary service connection
4 equipment. This adjustment annualizes, in accordance with Commission
5 annualization rules, the ordered changes for 1998. Adjustment 3.7 decreases Utah
6 test period revenues by $1,356,813.

7 Q. Please explain the O&M adjustments summarized under Tab 4, page 4.0.

8 A. **FAS 106 Deferred Charges** (Adjustment 4.1) – FAS 106 established accounting as
9 well as disclosure standards for employers with post-retirement benefit plans. It
10 requires that post-retirement benefit expenses be recognized or accrued while
11 employees are actively employed and earning these benefits rather than after they
12 have retired. Under the accrual accounting method the annual benefit expense is
13 determined through actuarial studies. Prior to this order PacifiCorp was accounting
14 for these benefits on a pay-as-you-go (i.e. cash) basis. Under the pay-as-you-go
15 method the annual benefit expense is equal to the amount that the Company actually
16 paid to employees during the year. The Oregon Public Utilities Commission and the
17 Wyoming Public Service Commission authorized the Company to defer FAS 106
18 costs that exceeded pay-as-you-go until 1996. In 1996 the Company stopped deferring
19 this difference and began amortization of the accumulated balances. The deferred
20 costs are now being amortized to Account 929, which is allocated system wide on a
21 System Overhead (SO) allocation factor. Adjustment 4.1, which was previously
22 adopted by the Utah Commission in Docket No. 97-035-01, is necessary to correct the
23 allocation of these costs, which should be directly assigned to Wyoming and Oregon.

1 This adjustment decreases Utah allocated expense by $546,435 and decreases rate
2 base by $120,845.
3 **FICA Adjustment** (Adjustment 4.2) – Effective in 1999, the earnings base for social
4 security increased. This change increases the Company's expense for this tax. This
5 adjustment reflects the FICA tax increase associated with the larger payroll base that
6 results from the annualized General Wage increase (Adjustment 4.5). The general
7 wage increase is based on direct labor and does not include overheads such as FICA
8 taxes. Adjustment 4.2 increases Utah tax expense by $30,832.
9 **1998 Early Retirement** (Adjustment 4.3) – PacifiCorp's 1998 early retirement
10 program is described by Robert R. Dalley. Adjustment 4.3 removes Utah's allocated
11 share of nonrecurring costs incurred in 1998 and 1999 in connection with this early
12 retirement program from the test period and amortizes the total impact of the program
13 over a five-year period. The amortization period is consistent with the Commission's
14 order in Docket No. 90-035-08, dated April 25, 1990, which authorized a five-year
15 amortization of costs associated with a similar PacifiCorp voluntary early retirement
16 program.
17 Adjustment 4.3 reflects the total realized savings from the program in two
18 components. The first component annualizes a full year of 1998 cost savings from the
19 retirement program into the test period, matches these savings with 1998 program
20 costs, which are amortized over five years. The second component recognizes
21 savings attributable to post-1998 retirees, matches these savings with post-1998
22 program costs, which are also amortized over five years. The purpose of this
23 adjustment is to ensure that Utah customers receive the full benefit of the early

1 retirement program while spreading recovery of associated costs over a reasonable
2 period.
3 Adjustment 4.3 decreases Utah operating expenses by $50,108,145 and
4 increases rate base by $13,712,883 (the unamortized balance of early retirement
5 costs), and properly reflects associated deferred income tax effects.
6 **Remove LTIP** (Adjustment 4.4) – This adjustment removes the cost of PacifiCorp's
7 long-term executive incentive compensation plan, LTIP or Long-Term Incentive Plan,
8 from the 1998 test period in accordance with the Commission's order in Docket No.
9 97-035-01. Adjustment 4.4 reduces Utah allocated operating expense by $508,411.
10 **General Wage Increase-Annualized** (Adjustment 4.5) – PacifiCorp has several
11 labor groups, each with different effective contract renewal dates. The Company
12 negotiates wage increases with each of these groups throughout the year. Adjustment
13 4.5 annualizes, in accordance with Commission annualization rules, the effective
14 wage increases received during 1998 for labor charged to operation and maintenance
15 accounts. This annualization was calculated by identifying actual wages for each labor
16 group, by month and then applying the negotiated wage increase to the wages for the
17 months prior to the effective contract date. This adjustment restates expense as though
18 the wage increase was effective for the entire test period, in a manner consistent with
19 a similar adjustment contained in the stipulation approved by the Commission in
20 Docket No. 97-035-01. Adjustment 4.5 increases Utah's allocated share of operating
21 and maintenance expense by $468,142.
22 **Uncollectible Accounts** (Adjustment 4.6) – This adjustment has two components.
23 The first component reverses the actual 1998 provision for bad debts and restates the

1 test period bad debt expense by calculating a three-year average of bad debt write-offs
2 (1996-1998) as a percent of average receivables. The three-year average was then
3 applied to the 1998 average receivables. Use of the average reduces Utah bad debt
4 expense by $3,438,410. This method of normalizing uncollectible accounts was
5 approved by the Commission in Docket 97-035-01.
6 The second component of this adjustment corrects the uncollectible allocation.
7 During 1998, most of the Company's bad debt expense was recorded using a general
8 office accounting location. Use of this location caused the jurisdictional allocation
9 reporting system to allocate these costs on a CN factor rather than directly assigning
10 them to the appropriate jurisdiction. This adjustment corrects that allocation error,
11 reversing the CN allocation and directly assigning Utah's bad debt expense. The
12 allocation correction reduces Utah bad debt expense by $520,023.
13 In total, Adjustment 4.6 decreases Utah bad debt expense by $3,958,433 and
14 recognizes the associated deferred income tax effects.
15 **Pension Adjustment** (Adjustment 4.7) – In 1997, PacifiCorp adopted the method of
16 recognizing pension expense mandated by FAS 87 for financial reporting purposes.
17 However, for ratemaking purposes the Company has been allowed to treat FAS 87/88
18 pension costs on a pay-as-you-go basis by its regulatory commissions, in Utah in
19 Docket 87-035-16, dated March 16, 1987. On this basis, the write-off of the FAS
20 87/88 regulatory asset was reversed in Docket 97-035-01 and the pension funding
21 level for ratemaking purposes was used in the case. Rather than continuing to
22 maintain regulatory accounting records based on pension funding levels as opposed to
23 the FAS 87/88 accrual levels, the Company has chosen to follow FAS 87/88 for

1 accounting and ratemaking and to amortize the regulatory asset for FAS 87/88 over 5
2 years. This adjustment increases the pension expense recorded in the 1998 test year
3 by the amount of this amortization. Adjustment 4.7 increases Utah's allocated share
4 of pension expense by $6,398,103 and reflects the appropriate deferred income tax
5 effects.
6 **Remove Prior Year Incentive Accrual** (Adjustment 4.8) – In 1998, an additional
7 amount of expense related to 1997 incentive awards was accrued to properly reflect
8 the amount accrued to the amount paid out for 1997. This adjustment removes this
9 prior period accrual. Adjustment 4.8 reduces Utah allocated expense by $1,000,368.
10 **DSM Third Party Financing** (Adjustment 4.9) – In February 1995, PacifiCorp
11 transferred its weatherization loans to its wholly-owned subsidiary, DSR, Inc., and
12 Citibank purchased 72.27% of these loans from the subsidiary. In 1995, 1996 and
13 1997, this adjustment reflected the interest expense paid to Citibank on the transferred
14 loans and adjusted rate base to include the weatherization loan balances that remained
15 on DSR, Inc.'s books. However, by 1998, it had become apparent that new DSM
16 investment was not meeting the Company's original expectations in terms of volume,
17 and thus the expected cost advantages of the program were not being realized.
18 Therefore, in November 1998, DSR, Inc. purchased all the loans back from Citibank
19 at book value, and in December 1998, transferred all of the loans back to the
20 Company. This adjustment is necessary to reflect the loan amounts as though they
21 had been on the Company's books since January 1, 1998. Adjustment 4.9 increases
22 Utah revenues by $487,038 and increases rate base by $4,423,928.

1 **Non-Regulated Pension Expense** (Adjustment 4.10) – PacifiCorp bills its non-
2 regulated subsidiaries for benefits provided to their employees. Certain pension
3 expenses and post retirement benefits billable to subsidiaries were inadvertently left
4 in Administrative and General Expense in 1998. This adjustment removes those
5 expenses from the test period. Adjustment 4.10 reduces the administrative and
6 general expense allocated to Utah by $212,763.
7 **Institutional Advertising Expense** (Adjustment 4.11) – Adjustment 4.11 removes
8 the cost of institutional advertising expense from electric operations consistent with
9 prior Commission orders. A similar adjustment for institutional advertising was
10 approved in the Commission order in Docket No. 97-035-01. Adjustment 4.11
11 reduces Utah test period expense by $12,848.
12 **Corporate Shareholder Services** (Adjustment 4.12) – The expenses of PacifiCorp's
13 Shareholder Services Department are charged 100 percent to electric operations. This
14 adjustment removes the shareholder services expenses related to the Company's
15 subsidiaries from the test period, based on the three-factor formula used by the
16 Company for allocating and billing expenses to non-regulated subsidiaries. A similar
17 adjustment was previously approved by the Commission in Docket No. 97-035-01.
18 Adjustment 4.12 reduces Utah test period expense by $145,823.
19 **Customer Service Deposit** (Adjustment 4.13) – PacifiCorp pays customers interest
20 on their service deposits per Commission rule, in accordance with Electric Service
21 Regulation No. 9. This adjustment is necessary for the Company to recover the
22 interest paid on deposits. A similar adjustment was approved by the Commission in
23 Docket No. 97-035-01. The customer service deposits are included as a rate base

1 deduction, and customer service deposit interest is recognized in cost of service as an
2 offset to the rate base deduction. Absent this adjustment, the interest true-up
3 (Adjustment 7.1) would nullify any recovery of service deposit interest. Adjustment
4 4.13 reflects the 6% interest rate on customer deposits approved by the Commission
5 in Docket 97-035-01. It increases Utah test period expense by $79,479 and reduces
6 rate base by $1,803,566.
7 **1998 PacifiCorp Trans Adjustment** (Adjustment 4.14) – In Docket No. 97-035-01,
8 the Commission approved adjustments for air travel costs aboard Company aircraft
9 and commercial travel billings from PacifiCorp Trans. PacifiCorp is working on the
10 development of a tracking system for use in the future. In the interim, the Company
11 believes that the pattern of aircraft usage in 1997 and 1998 is comparable. Therefore,
12 this adjustment calculates the percentage of 1997 Utah-allocated corporate aircraft
13 costs disallowed and applies the same percentage to 1998 Utah-allocated costs to
14 determine the 1998 disallowance. Adjustment 4.14 reduces Utah test period expense
15 by $184,487.
16 **FAS 112** (Adjustment 4.15) – PacifiCorp accrued an amount that was believed to be
17 necessary to cover the actuarial liability for post-employment benefits at the end of
18 1998. In part due to the early retirement program, the actuarial liability was less than
19 anticipated. This adjustment removes from the test period the excess of the accrued
20 liability at year-end over the actuarial liability. The adjustment also removes the 1998
21 portion of the under-funded balance from December 1996 in accordance with the
22 Commission order in Docket No. 97-035-01. Since Utah customers have not paid for
23 the FAS 112 expense, the reduction to rate base for these funds is removed.

1 Adjustment 4.15 reduces the administrative and general expense allocated to Utah by
2 $2,195,115 and increases rate base by $ 4,599,592.
3 **Corporate Management Fee Allocation** (Adjustment 4.16) – Adjustment 4.16
4 annualizes corporate overhead expenses allocated to electric operations by applying
5 the year-end three factor allocation formula to the total 1998 corporate overhead
6 expense. This adjustment was approved by the Commission in Docket No. 97-035-
7 01. Adjustment 4.16 increases administrative and general expense allocated to Utah
8 by $268,075.
9 **Market Position and Futures** (Adjustment 4.17) – This adjustment removes the
10 impact of losses from market position trading and futures contracts from the test
11 period. Since the Company has greatly curtailed its involvement in these types of
12 transactions, the 1998 losses are not indicative of ongoing expense. Adjustment 4.17
13 reduces Utah allocated revenues by $461,176,608 and reduces Utah allocated
14 operating expense by $463,671,909.
15 **Re-engineering** (Adjustment 4.18) – Accounting for re-engineering costs is described
16 by Robert R. Dalley. Adjustment 4.18 reflects the first year of a five-year
17 amortization of $16,274,127 in re-engineering costs incurred in connection with the
18 preparation and design of the SAP software application. The adjustment removes the
19 $6,274,127 re-engineering cost incurred in 1998 from the test period and includes
20 $3,254,825 of 1997 and 1998 re-engineering cost amortization. This treatment is
21 consistent with the treatment authorized by the Commission in the 1995 US West rate
22 case, Docket No. 95-049-05 and affirmed in 97-049-08. Adjustment 4.17 decreases

1 Utah allocated administrative and general expense by $1,061,385 and increases Utah
2 allocated rate base by $4,046,024.

3 Q. Please explain the Net Power Cost adjustments summarized under Tab 5, page 5.0.

4 A. **Net Power Cost Study** (Adjustments 5.1 and 5.2) – As described in Mark T.
5 Widmer's testimony, the net power cost adjustment normalizes steam and hydro
6 power generation, fuel, purchased power, wheeling, and sales for resale in a manner
7 consistent with normalized operation of production facilities. These costs and
8 revenues are normalized because they are sensitive to weather conditions and the
9 wholesale market. The report breaks the net power cost adjustment into two
10 components—referred to as T1 and T2. T1 on page 5.1 adjusts sales for resale, fuel,
11 purchased power and wheeling expense to reflect normalized stream flow and weather
12 conditions for the period ending December 31, 1998 in accordance with the
13 stipulation in Docket No. 97-035-01. T2 on page 5.2 annualizes resources, firm
14 purchases and firm sales to the level or price that existed in December 1998. The net
15 impact of Adjustments 5.1 and 5.2 is to reduce Utah revenues by $88,070,672, with
16 an offsetting reduction in operating expense of $88,250,502.

17 **Incremental Coal Discount Adjustment** (Adjustment 5.3) – Wyodak, Bridger, and
18 Naughton Plants receive a discount on every ton received above a threshold amount.
19 The cost per ton for these three plants used in the Net Power Cost Study is based on
20 actual tons. Because the normalized tons (Net Power Cost Study) differ from the
21 actual tons due to hydro conditions, weather conditions, system load, market price,
22 etc., an adjustment is required to properly reflect the impact of the discount on the
23 normalized tons. For example, if normalized tons are less than actual tons at Bridger,

1 the number of tons above the threshold tonnage limit would be reduced. Therefore, a
2 smaller number of tons would receive the lower cost per ton achievable above the
3 threshold. The incremental coal discount adjustment matches the normalized tonnage
4 level in the Net Power Cost Study with the credit that would have been received at
5 that level. This adjustment increases Utah's allocated share of fuel expense by
6 $581,995.

7 Q. Please explain the depreciation and amortization adjustments summarized under Tab
8 6, page 6.0.

9 A. **Annualized Depreciation Expense** (Adjustment 6.1) – During part of 1998 the
10 Company recorded depreciation expense using rates from the 1996 depreciation study
11 which was filed with the Commission for approval and subsequently withdrawn.
12 Therefore, this adjustment is necessary to reflect on-going depreciation expense based
13 on the current Commission-approved rates and depreciable plant balances. The
14 adjustment was calculated by applying the currently authorized depreciation rates to
15 1998 beginning/end-of-year average depreciable plant balances. This annualized
16 amount was then compared to the actual depreciation expense recorded during 1998
17 to determine the amount of the adjustment. Adjustment 6.1 reduces the depreciation
18 expense allocated to Utah by $858,442 and reflects associated deferred tax effects.

19 **Annualized Accumulated Depreciation** (Adjustment 6.2) – Adjustment 6.1 reflects
20 on-going depreciation expense based on current rates and 1998 beginning/end-of-year
21 average depreciable plant balances. Adjustment 6.2 is necessary to reflect the impact
22 of Adjustment 6.1 on the accumulated depreciation reserve. Adjustment 6.2

1 decreases the accumulated depreciation allocated to Utah (thereby increasing rate
2 base) by $429,221, and reflects associated deferred tax effects.
3 **Correct Accumulated Depreciation Reserve** (Adjustment 6.3) – In December 1997,
4 PacifiCorp recorded an accounting entry to adjust depreciation expense to reflect the
5 proposed rates from its 1996 depreciation study. That entry increased the 1997 test
6 period depreciation expense by $15,953,898. In addition, in 1997 the Hermiston
7 generating plant was being depreciated using a twenty-year life, rather than a thirty-
8 five year life, thereby increasing depreciation expense by $3,565,255. In Docket No.
9 97-035-01, the impact of the 1996 depreciation study was removed from the 1997 test
10 period and the use of a thirty-five year life for Hermiston was included, in accordance
11 with the terms of a stipulation that was approved by the Commission on June 18,
12 1998. However, on the Company's books the accumulated depreciation reserve is
13 still overstated by the amount of the additional depreciation expense recorded in
14 1997. This adjustment reduces the amount of accumulated depreciation included in
15 the 1998 test period rate base to reflect a balance that is consistent with the stipulation
16 referenced above. Adjustment 6.3 reduces Utah's allocated share of accumulated
17 depreciation, thereby increasing rate base by the amount of $4,200,727.
18 Q. Please explain the interest and tax adjustments summarized under Tab 7, page 7.0.
19 A. **Interest True-up** (Adjustment 7.1) – Since interest expense is a cost of financing rate
20 base through debt securities, it is appropriate to synchronize or true-up the amount of
21 interest expense in the test period with the related amount of rate base in that test
22 period. This true-up is accomplished by multiplying the Utah adjusted rate base for
23 1998 by the Company's current weighted cost of debt. The interest determined in this

1 manner is then compared to the actual interest recorded in 1998 to determine the
2 necessary adjustment. For ratemaking purposes, interest expense is a deduction in
3 determining income taxes. This interest true-up methodology was approved by the
4 Commission in Docket No. 97-035-01. The revenue requirement impact of the
5 interest true-up is reflected as a change in income tax expense. Adjustment 7.1
6 reduces the interest expense allocated to Utah by $9,925,180, thereby increasing
7 income tax expense by $3,791,672.

8 Q. Please explain the rate base adjustments summarized under Tab 8, page 8.0.

9 A. **Environmental Settlement** (Adjustment 8.1) – In 1996, PacifiCorp received an
10 insurance settlement of $33 million for environmental clean-up projects. These funds
11 were transferred to a subsidiary called PacifiCorp Environmental Remediation
12 Company (PERCO). In 1998 PERCO received an additional $5 million of insurance
13 proceeds. This adjustment is necessary to reflect the insurance proceeds in the test
14 period as a reduction to rate base. The rate base credit will be reduced or amortized
15 over time as PERCO expends dollars on clean-up costs. The adjustment is consistent
16 with the Stipulation dated October 8, 1998 that was approved by the Commission in
17 Docket No. 97-035-01. Adjustment 8.1 reduces Utah allocated rate base by
18 $10,825,716.

19 **CSS Disallowance** (Adjustment 8.2) – This adjustment removes one-third of the
20 Company's investment in its Customer Service System (CSS) software from the 1998
21 test period, consistent with the stipulation dated October 8, 1998 that was adopted by
22 the Commission in Docket No. 97-035-01. Adjustment 8.2 reduces Utah test period

1 rate base by $8,980,936, decreases test period software amortization expense by
2 $1,056,581.
3 **Trapper Mine Rate Base** (Adjustment 8.3) – PacifiCorp owns a 21.47% interest in
4 the Trapper Mine, which provides coal to the Craig generating plant. The normalized
5 coal cost for Trapper includes all operating and maintenance costs but does not
6 include a return on investment. This adjustment is necessary to add the Company-
7 owned portion of Trapper Mine plant investment to rate base, since this investment is
8 recorded in Account 123.1 – Investment in Subsidiary Company. Account 123 is not
9 normally a rate base account. The adjustment reflects net plant rather than the actual
10 balance in Account 123 to recognize the depreciation of the investment over time.
11 Adjustment 8.3, which was approved by the Commission in Docket No. 97-035-01,
12 increases Utah allocated rate base by $1,867,527.
13 **Bridger Coal Co. Rate Base** (Adjustment 8.4) – PacifiCorp owns a two-thirds
14 interest in the Bridger Coal Company, which supplies coal to the Jim Bridger
15 generating plant. The Company's investment in Bridger Coal Company is recorded
16 on the books of Pacific Minerals, Inc. (PMI), a wholly-owned subsidiary. Because of
17 this ownership arrangement, the coal mine investment is not included in electric plant
18 in service. The normalized coal costs for Bridger Coal Company include the
19 operating and maintenance costs of mining, but provide no return on investment.
20 Therefore, this adjustment is necessary to properly reflect the Bridger Coal Company
21 plant investment in test period rate base. Adjustment 8.4, which was approved by the
22 Commission in Docket No. 97-035-01, increases Utah allocated rate base by
23 $15,432,988.

1 **Dave Johnston Mine Closure** (Adjustment 8.5) – The Dave Johnston Mine closure
2 (also referred to as Glenrock Closure) is discussed by Robert R. Dalley. Adjustment
3 8.5 reflects a three-year amortization of mine closure costs, beginning in 1998. By so
4 doing, the Company has matched 1998 fuel savings with the additional costs caused
5 by the early closure of the mine. Adjustment 8.5 increases Utah allocated fuel costs
6 by $7,440,997, increases rate base by $17,456,856 and appropriately reflects deferred
7 tax effects.

8 **Business Systems Integration Project (BSIP) Adjustments**

9 PacifiCorp has undertaken a Business Systems Integration Project (BSIP) designed to
10 re-engineer Work Management, Materials Management, Human Resources/Payroll
11 and Financial systems. Adjustments 8.6, 8.7 and 8.8 reflect changes that were
12 required to accomplish the BSIP program, in addition to Adjustment 4.18 (Re-
13 engineering) that was described earlier. Adjustment 8.6 deals with the replacement of
14 the obsolete mainframe computer, Adjustment 8.7 introduces the new SAP enterprise-
15 wide software product, and Adjustment 8.8 reflects the retirement of obsolete
16 software systems. Each of these adjustments is described in detail below.

17 **Computer Mainframe Write-Down -** (Adjustment 8.6) – The accounting treatment
18 for the computer mainframe write-down is described by Robert R. Dalley.
19 Adjustment 8.6 is necessary to adjust the 1998 test period to reflect the computer
20 equipment write-down booked in 1997 but determined by the Commission in Docket
21 No. 97-035-01 to be a future event for ratemaking purposes. This adjustment
22 amortizes the write-down over three years, beginning in 1998. The adjustment
23 increases Utah allocated depreciation expense by $1,423,653, and increases rate base

1 by $3,559,132 (to recognize the unamortized balance of the write-down), and
2 appropriately reflects deferred tax effects.
3 **SAP Rate Base Adjustment** (Adjustment 8.7) – The accounting treatment given to
4 SAP costs is described by Robert R. Dalley. In order to properly reflect the impact of
5 SAP software system costs on test period revenue requirement, Adjustment 8.7
6 increases Utah allocated software amortization costs by $1,980,466, increases
7 depreciation of general plant by $345,811 (for SAP-related computer hardware
8 additions), increases rate base by $12,496,220 and reflects associated deferred taxes.
9 **Software Write-down** (Adjustment 8.8) – The accounting treatment for the software
10 write-down is described by Robert R. Dalley. Adjustment 8.8 is necessary to adjust
11 the 1998 test period to reflect the software write-down booked in 1997 but determined
12 by the Commission in Docket No. 97-035-01 to be a future event for ratemaking
13 purposes. This adjustment amortizes the software write-down over three years,
14 beginning in 1998. The adjustment increases Utah allocated software amortization
15 expense by $813,870 and increases rate base by $2,034,675 (to recognize the
16 unamortized balance of the write-down), and appropriately reflects deferred tax
17 effects.
18 **Other Rate Base Adjustments**
19 **Update Cash Working Capital** (Adjustment 8.9) – This adjustment is necessary to
20 true-up cash working capital for the normalizing adjustments made in this filing,
21 using the method approved by the Commission in Docket No. 97-035-01. Cash
22 working capital is calculated by taking total operation and maintenance expense
23 allocated to Utah (excluding depreciation and amortization) and adding Utah's

1 allocated share of taxes, including state and federal income taxes and taxes other than
2 income. This total is then divided by the number of days in the year to determine the
3 Company's adjusted daily cost of service. The daily cost of service is multiplied by
4 the Company's net lag days to produce the cash working capital. Adjustment 8.9
5 reduces Utah rate base by $14,888,706.
6 **Organization Cost Rate Base Adjustment** (Adjustment 8.10) – This adjustment is
7 necessary to reflect the agreement between the Company and the Division of Public
8 Utilities (DPU) relative to the sharing of the UP&L/PP&L merger costs between
9 shareholders and customers. The agreement, which was communicated to the
10 Commission in a letter dated October 28, 1988, provides that merger costs are
11 subtracted from rate base and the amortization expense is left in test period results.
12 The Commission accepted this adjustment in Docket No. 97-035-01. In 1998, the
13 remaining amortization was adjusted to match the Commission-ordered phase-in
14 period to rolled-in allocation and the elimination of merger-cost-related issues.
15 Adjustment 8.10 increases Utah test period amortization expense by $573,611,
16 decreases rate base by $4,733,523 and appropriately reflects deferred income tax
17 effects.
18 **APS Combustion Turbine Payment** (Adjustment 8.11) – In December 1996,
19 PacifiCorp recorded a $20 million payment to Arizona Public Service Company
20 (APS) pursuant to a combustion turbine construction agreement that was part of the
21 August 1991 contract to purchase the Cholla 4 generating station. This payment was
22 recorded as a deferred debit in Account 182.399 and is being amortized over 26 years
23 beginning in August 1991. This adjustment removes the average unamortized

1 balance of the deferred debit from rate base. A similar adjustment was accepted by
2 the Commission in Docket No. 97-035-01. Adjustment 8.11 reduces Utah allocated
3 rate base by $5,037,667.

4 **QF Contract Buyouts** (Adjustment 8.12) – Under the 1978 Public Utilities
5 Regulatory Policy Act (PURPA), investor-owned utilities were required to purchase
6 power from qualifying generation facilities. These contracts, which have been
7 approved by state regulatory commissions, are known as Qualified Facilities (QF)
8 contracts. During 1998 the Company negotiated buy-outs from two uneconomical QF
9 contracts at less than the future required payments under the contracts. These buy-
10 outs are being amortized over the remaining lives of the contracts. This adjustment
11 removes out-of-period amortization expense related to 1997 for one contract and
12 annualizes a full year of amortization into the test period for the other. It also restates
13 the beginning balances of both contracts to reflect a full year's amortization.
14 Adjustment 8.12 decreases Utah allocated operating expense by $15,978 and
15 increases rate base by $658,600.

16 **Remove Pension and Benefits Reserve** (Adjustment 8.13) – In October 1998, a new
17 account was set up for Pension and Benefits Reserve – Termination Pay. This
18 account should be a rate base deduction, but it was not correctly identified in the
19 Company's 1998 unadjusted results of operations. Adjustment 8.13 includes this new
20 account as a rate base deduction, reducing Utah allocated rate base by $989,061.

21 **Remove Garfield Coal** (Adjustment 8.14) – In compliance with the Commission's
22 order in Docket No. 97-035-01 this adjustment removes all costs associated with

1 Garfield mineral rights negotiations. Adjustment 8.14 reduces Utah allocated rate
2 base by $319,025, and appropriately reflects deferred tax effects.
3 **Plant Held for Future Use** (Adjustment 8.15) – The Company's steam plant-related
4 Plant Held for Future Use was written-off in 1998. This adjustment removes the
5 average investment in this property from the test period. This adjustment is consistent
6 with the stipulation dated October 8, 1998 that was approved by the Commission in
7 Docket No. 97-035-01. Adjustment 8.15 reduces Utah allocated rate base by
8 $423,165.
9 **Remove SERP Reserve** (Adjustment 8.16) – Supplemental Executive Retirement
10 Plan (SERP) expense is accrued each year in accordance with the actuarial report.
11 The excess of this accrual over payouts under the plan is recorded as a liability. The
12 SERP reserve liability account was not identified as a rate base deduction in the
13 Company's unadjusted results. This adjustment reflects the SERP reserve as a rate
14 base reduction. Adjustment 8.16 reduces Utah allocated rate base by $3,803,639.
15 **Materials Allocation Correction** (Adjustment 8.17) – During 1998, the costs of
16 some storerooms associated with steam and hydro generating plants were directly
17 assigned to the state in which they were physically located instead of being allocated
18 system-wide. This adjustment corrects the allocation. Adjustment 8.17 increases
19 Utah's allocated rate base by $4,299,428.
20 Q. Please explain the other adjustments summarized under Tab 9.
21 A. There are no "other adjustments" to the 1998 results of operation report. Tab 9 is
22 blank.

1 Q. Has the Company made an adjustment to remove research and development costs
2 from the test period?
3 A. No, research and development (R&D) costs have not been removed from test period
4 results. PacifiCorp's R&D costs relate to the development of renewable resources.
5 Working within the framework of its integrated resource planning (RAMPP) process,
6 the Company is committed to putting together a resource acquisition plan that will
7 provide the maximum benefit to the Company and its customers when evaluating a
8 range of important criteria, such as cost, risk diversification and environmental
9 impacts. As a utility that relies heavily on coal-fired generation, it is important for
10 PacifiCorp to diversify its resource mix by developing cost effective renewable
11 resources. In fact, the largest single R&D cost in the test period was incurred in
12 support of the Solar II project that explored the use of molten salt technology for
13 capturing and storing solar energy. The U.S. Department of Energy recently declared
14 Solar II to be a significant milestone in the development of large-scale solar projects
15 that will bring renewable energy a step closer to being a significant contributor to the
16 global energy mix. By participating in this project as part of a consortium of utilities,
17 PacifiCorp was able to share in the technical expertise at a very reasonable cost. As
18 part of its ongoing resource acquisition plan, the Company expects to continue to
19 invest in cost effective R&D projects that target the development of renewable
20 resource technologies. PacifiCorp considers such R&D investments prudent and in
21 the public interest.
22 **Conclusion**
23 Q. In summary what conclusion does your testimony support?

1 A. My testimony demonstrates that PacifiCorp's normalized earnings in its Utah service

2 territory supports a price increase of $67 million (9.9%).

3 Q. Does this conclude your testimony?

4 A. Yes.