Witness CCS - 5
Exhibit CCS-5

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

	)	**Docket No. 99-035-10**
In the Matter of the Application of	)	
PacifiCorp for Approval of its	)	**PRE-FILED DIRECT TESTIMONY OF**
Proposed Electric Rate Schedules	)	**MICHAEL L. BROSCH**
and Electric Service Regulations	)	**FOR THE COMMITTEE OF**
	)	**CONSUMER SERVICES**

February 4, 2000

Non-Confidential Version

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PREPARED TESTIMONY OF
MICHAEL L. BROSCH

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Q. Please state your name and business address.

A. My name is Michael L. Brosch. My business address is 740 North Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

Q. By whom are you employed?

A. I am a principal in the firm Utilitech, Inc., a consulting firm engaged primarily in utility rate and regulation work. The firm's business and my responsibilities are related to special services work for utility regulatory clients, including rate case reviews, cost of service analyses, jurisdictional and class cost allocations, financial studies, rate design analyses, and focused investigations related to utility operations and ratemaking issues.

Q. On whose behalf are you appearing in this proceeding?

A. I am appearing on behalf of the Utah Committee of Consumer Services ("Committee", or "CCS"). Utilitech entered into a contract with the Committee of Consumer Services to review and respond to the rate case filing of PacifiCorp, which does business as Utah Power & Light (“PacifiCorp” or ”Company”) in Utah. In conjunction with other CCS consultants, I have prepared this testimony and sponsor certain Committee revenue requirement adjustments as a result of such engagement.

Q. Will you summarize your educational background and professional experience in the field of utility regulation?

A. I graduated from the University of Missouri, Kansas City, in 1978 with a Bachelor of Business Administration Degree, majoring in accounting. I hold a CPA Certificate in the State of Missouri and in the State of Kansas. I am a member of the American Institute of Certified Public Accountants, the Missouri Society of Certified Public Accountants, and the Kansas Society of Certified Public Accountants. Since completion of formal education, my entire professional career has been dedicated to utility operations and regulation consulting.

From 1978 to 1981, I served as a public utility accountant with the Staff of the Missouri Public Service Commission. While employed by the Missouri Commission, I participated in rate case examinations involving electric, gas, water, steam, transit, and telephone utilities operating in Missouri.

In December, 1981, I accepted employment with Troupe Kehoe Whiteaker & Kent, a Kansas City CPA firm, in its public utility department. While with Troupe Kehoe Whiteaker & Kent, I was involved in the review, analysis, and presentation of a wide range of utility rate case issues and various other utility management advisory functions for both utility company and regulatory agency clients. In May of 1983, I commenced employment with Lubow McKay Stevens and Lewis, an accounting and public utility consulting firm. While with that firm, I was involved in numerous regulatory proceedings and directed the conduct of a variety of special projects.

In June of 1985, Dittmer, Brosch and Associates, Inc. (now Utilitech, Inc.) was organized. The firm specializes in public utility regulatory and management consulting in the electric, gas, telecommunications, water, and waste water industries. As a principal of the firm, I am responsible for the supervision and conduct of the firm's various regulatory projects. A majority of the firm's business involves representation of utility commission staff and consumer advocate intervenors in utility rate proceedings and special or focused investigations. In 1992, the firm was renamed Utilitech, Inc. to coincide with the admission of Mr. Steven Carver as a stockholder.

I have testified before utility regulatory agencies in Arizona, Arkansas, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, Ohio, Oklahoma, Washington and Wisconsin in regulatory proceedings involving electric, gas, telephone, water, sewer, transit, and steam utilities.

Q. Have you previously participated in Utah regulatory proceedings?

A. Yes. My firm participated in the last PacifiCorp rate case, Docket No. 97-035-01 and in the most recent general rate case involving U. S. West, on behalf of the Committee. The issue areas I addressed in the last PacifiCorp rate case generally correspond with the work and issues I address at this time. Since the last rate case, I have assisted the Committee in Allocation Task Force meetings conducted by the Division of Public Utilities ("Division") as well as the preparation of Comments filed in that matter by the Committee.

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

A. My testimony is intended to describe and sponsor, on behalf of the Committee, three adjustments to the allocated PacifiCorp Corporate Group and an adjustment of PacifiCorp Trans., Inc. aircraft expenses that are charged to Utah operations in the test year. My testimony and ratemaking recommendations are incorporated into CCS Exhibit 1.1, the Committee's adjustment schedules, as described and jointly sponsored by Larkin and Associates witness Mr. Hugh Larkin. The PacifiCorp Corporate Group adjustments I sponsor relate to the Company's President/CEO cost allocations (Exhibit 5.1) , the quantification of stock-based incentive compensation to be disallowed (Exhibit 5.2) and the disallowance of certain test period strategic consulting costs (Exhibit 5.3). With regard to the PacifiCorp Trans., Inc. affiliate, I recommend an adjustment to exclude excessive costs and normalize for the reduced size of the aircraft fleet at test year end (Exhibit 5.4).

In addition to these test period adjustments, my testimony also addresses procedural recommendations to improve accounting for PacifiCorp shared corporate transactions in the future. The Company presently allocates all of its corporate group management and administrative costs using generalized 3-factor allocations based upon the relative size of certain operating units and subsidiaries. This 3-factor process is imprecise and inequitable and should not continue upon implementation of the merger with ScottishPower. Comprehensive study of all shared corporate and administrative functions must occur in order to more directly attribute costs to the business units that benefit from employee activities in each function. I recommend that the Utah Public Service Commission ("Commission") direct PacifiCorp to conduct comprehensive studies aimed at evaluating shared corporate costs and implementing improved direct charging of costs to entities benefited and more cost-causative (rather than generalized) allocation methods for all costs not directly assigned.

Q. How is the balance of your testimony organized?

A. My testimony is arranged by issue area. An index appearing at the beginning of the testimony sets forth this organization.

CORPORATE GROUP EXPENSE ALLOCATIONS

Q. What types of corporate costs are incurred by PacifiCorp and allocated to electric operations

as well as other subsidiaries?

A. The activities and costs of PacifiCorp's senior executive management and certain centralized corporate administrative staff functions are organized within what is called "Corporate Group" responsibility centers (RC's), in which costs are accumulated and allocated among the various business units controlled by PacifiCorp. The Corporate Group RC's include the following business administrative functions:

Corporate President	Internal Audit	Chief Financial Officer
Investor Relations	Corporate Finance	Corporate Secretary
Corporate Administration	Accounting & Reporting	Investment Management
Events & Special Projects	Financial Reporting	Tax Management & Planning
Tax Reporting	Property & Revenue Tax	Financial Services System

Incurred expenses within each RC are accumulated and, unless specifically charged to a particular entity or work order, become part of a Corporate Management Fee that is allocated among all the businesses controlled by PacifiCorp using a 3-factor allocation formula.

<u>Test Period Allocation of Corporate Group Costs</u>

Q. What was the test period total amount of charges associated with Corporate Group Management Fee?

A. According to the Company's Affiliated Interest Report for 1998, at page 162, actual Management Fee charges totaled $22.5 million. After allocation, domestic electric operations' share of this expense was $17.8 million. However, the amounts

contained in PacifiCorp's Semi-annual Report used as the starting point for revenue requirement determination in this Docket supported slightly lower amounts for Corporate Group costs, reflecting some "Basis Corrections". At workpaper page 4.16, the Company based an adjustment to annualize Corporate Group allocations upon assumed total costs of $22.4 million, with $18.4 million of this amount charged to domestic electric operations.

Q. What is the "Corporate Management Fee Allocation" adjustment that PacifiCorp has proposed at Schedule 4.16 of its filing?

A. The Company has proposed an adjustment to modify recorded test period Management Fee allocations of Corporate Group expenses, so as to reflect revised allocation factors calculated based

upon relative expenses, investment and numbers of employees (the three factors) as of December 31, 1998. In the last rate case, the Company proposed a similar adjustment to annualize the 3-factor allocations at the end of the test period, which was accepted by the Commission. At year-end 1998, the 3-factor percentage to Domestic Electric ("DE") operations is 82.14 percent, using year-end adjusted input values. The effect of moving to the year-end 3-factor allocation is an increase to Utah expenses of $268,075.

Q. Is it possible to summarize and compare the gross and DE-allocated share of Corporate Group expenses in the last rate case and in the current case?

A. Yes. The following table indicates the comparable gross and Corporate Group expenses in 1997 and in 1998, showing the effects of 3-factor allocations used during 1997, at year-end 1997, during 1998, and at year-end 1998:

Corporate Group Year/Method	Gross $ Corporate Group	DE 3-Factor % Allocator	Domestic Electric $
1997 - Using Average 3-factor	16,532,828	67.3%	11,123,574
1997 - Using Year end 3-factor	16,532,828	77.6%	12,829,474
1998 - Using Average 3-factor	22,406,320	78.9%	17,678,586
1998 - At October 1999 3-factor	22,406,320	82.14%	18,404,551

While the amounts in the right hand column for total domestic electric operations remain subject to further allocation to Utah retail operations, this chart illustrates the unfavorable trend toward dramatically increasing gross corporate group costs, as well as unfavorable trends in the DE factor that charges continuously increasing shares of such increasing costs to the domestic electric utility operations.

Q. What was the Corporate Group allocation issue in the last case and how was it resolved?

A. The Company successfully argued for an adjustment annualizing the 3-factor formula as of year-end 1997. During the 1997 test period used in the last rate case, the 3-factor allocation formula used to allocate Corporate Group expenses changed materially, due to the sale by PacifiCorp of its telecommunications subsidiary, Pacific Telecom, Inc.(PTI), and due to the sale of the Pacific

Generation Corporation (PGC) business. The percentage of Corporate Group charges attributed to domestic electric operations in 1997, before and after the sale of PTI and PGC were as follows:

January - October 1997	65.7 % electric operations
November 1997 (after PGC sale)	66.1 % electric operations
December 1997 (after PTI sale)	77.6 % electric operations

Since the 3-factor formula is driven by relative size based input values, the electric operations inherit an ever larger share of total corporate group costs as a mathematical result of PacifiCorp's decision to divest PTI and PGC. The trend has continued through 1998, where the "return to roots" philosophy has led to further divestiture of PacifiCorp's share of the Hazelwood power plant located in Australia.

Q. Has the Company continued to reduce the level of its diversified investments and operations since the last rate case?

A. Yes. Upon the termination of the previous President and CEO, Mr. McKennon was elected CEO in September of 1998. According to the Annual Report to Shareholders, Mr. McKennon "... met with securities analysts, investors, customers and employees and the message was clear: the company required a new, fully focused and achievable strategic direction." The 1998 Annual Report, at page 4, continues in describing that direction:

> That strategy is to return to our roots, to the business we know best. In October, we announced that we would focus on our western U.S. electricity business and sell or shut down all unrelated endeavors with the exception of Powercor, our Australian electricity distribution company. We also embarked on an aggressive program to cut costs to address our realization that PacifiCorp must be smaller, leaner and have lower overhead.

However, the "return to roots" philosophy and business divestitures that followed did not produce reduced 1998 corporate costs. In fact, gross corporate group expense increased by over 35 percent in 1998, and the 3-factor allocation to the remaining domestic electric operations increased as well.

Q. How does PacifiCorp explain the increase in gross corporate group expenses?

A. No explanation is offered in the Company's testimony. However, responses to Committee data requests indicate extraordinary costs are included that are associated with external consulting fees and expenses. Increased costs are also included for stock-based compensation for other executives, even though these costs were disallowed in the Commission's last rate order. Specific Committee

adjustments are proposed and described more fully herein, to deal with these cost issues and reduce test period corporate group expenses to more reasonable levels.

In addition, large one-time expenses were recorded as corporate group expenses for the relocation of the accounting functions from Salt Lake City to Portland during the test period. PacifiCorp has proposed its own adjustment to normalize these costs at Exhibit UP&L___.1(JKL-1), page 4.3. Committee witness Ms. DeRonne is addressing this adjustment in her testimony.

Prospective Corporate Cost Allocation Issues

Q. What are the elements of the 3-factor formula used by PacifiCorp to allocate Corporate Group expenses?

A. The Company's version of the 3-factor formula is a simple weighting of the relative operating expenses, number of employees and assets of the business segments controlled by PacifiCorp. With this approach, the larger the relative size of a subsidiary or division, the larger the percentage of Corporate Group costs that will be assigned. Since domestic electric operations represent the largest core holdings of PacifiCorp, having the largest number of employees, the largest operating expense and the largest asset balances, domestic electric operations receives the majority of corporate group costs.

Q. Is the 3-factor approach a reasonable basis for attribution of administrative shared expenses among PacifiCorp's portfolio of business holdings?

A. No. As I testified in the Company's prior rate case, relative size-based allocators are inherently imprecise indicators of the actual relationship between the "drivers" or "causes" of corporate costs and the beneficiaries of such corporate activities and costs. Use of the 3-factor methodology by PacifiCorp represents an admission that no analysis of cost causation or beneficiary identification for corporate group activity has been conducted. Simplicity has prevailed over equity in deeming an average number of employees, relative expenses and assets to be indicative of why costs are incurred and what entities benefit from corporate group activity.

Even though apparently quite simple in design, there are many judgments associated with PacifiCorp's application of the 3-factor approach that also tend to undermine its effectiveness. For example, the 82.14 percent factor being proposed for the DE 3-factor value in this case is not simply a

compilation of actual December 31, 1998 statistical and financial data, but such data has been adjusted for the following effects:

- Exclude domestic electric purchased power expenses from the "expense" value.
- Include 2/3 of Bridger assets in domestic electric's "asset" value.
- Exclude investment in Hazelwood Power Station from the "asset" value, even though not sold until April 1999.
- Use employee data as of June 30, 1999 rather than December 31, 1998, to "better reflect employees staying with the Company" after sale of PacifiCorp Power Marketing.
- Exclude employees at Klamath Energy because electric employees' costs are allocated to Klamath.
- Exclude PacifiCorp Group Holdings "because there are no significant management activities related to the assets held.

In my opinion, this sort of "tinkering" with the raw 3-factor formula tends to bias its results and undermine the presumed equity in adopting this simplistic approach in the first place.

Q. Have you made any ratemaking adjustments to restate for the 3-factor "tinkering" you refer to?

A. No. Complete information was not available to recalculate all of the variables in the formula as of December 31, 1998. Moreover, numerous issues would require Commission resolution to enable a recalculation of each of the Company's proposed adjustments to the raw data. I do not expect any major revenue requirement impact, given the magnitude of the various Company-proposed adjustments and the fact that Utah receives only a fraction of any changes that may result.

Q. Are there other reasons that the 3-factor allocation process is imprecise and inherently unfair to the electric operations?

A. Yes. Corporate Group employees and assets are included within the domestic electric statistics used to derive the 3-factor percentages, even though salaries and costs of Corporate Group are within the costs being allocated. This causes domestic operations to improperly bear a larger share of Corporate Group costs simply because the headcounts and assets of the Corporate Group happen to reside within the DE statistics. Another problem is that no Corporate Group costs are retained by the corporation as a holding company cost, so as to recognize that some activities and overheads of the business are associated with corporate development, merger and acquisitions search efforts, consolidated cash management and other activities not of tangible benefit to domestic electric

operations. In addition, start-up ventures, business units being sold or troubled business units tend to be subsidized under a relative size-based allocation scheme because such entities may require disproportionate levels of management attention and expense, even though they have relatively modest numbers of employees and fewer assets than more established affiliates.

Q. Does the Company make direct assignments of labor and other costs when Corporate Group personnel focus their attention upon specific projects or individual subsidiaries?

A. An effort is made to practice exception time reporting, so that an employee can remove salary and other costs from the default pool of Corporate Group costs subject to 3-factor allocation and charge such time/expense directly to a project. Examples include work on specific merger & acquisition projects, and specific projects undertaken for the benefit of individual subsidiaries such as PowerCor, where the incremental labor and other costs incurred are isolated and directly assigned. However, many corporate group employees do not routinely prepare time sheets to account for their labor. Moreover, it is obvious from comparisons of the labor charges redirected toward the ScottishPower merger project that the Company's procedures for direct charging of time are disfunctional and tend to significantly understate the amount of costs that should be removed from the Corporate Group expenses. I will elaborate upon this problem in the next section of testimony, where an adjustment is proposed to reclassify costs associated with the PacifiCorp President/CEO cost center below-the-line.

Q. Is this an appropriate time for the Commission to order PacifiCorp to conduct in-depth analyses of its Corporate Group functions, so as to derive more appropriate cost assignment and allocation processes?

A. It is my opinion, consistent with my position in the Company's last Utah rate case, that the inherent imprecision and the various concerns identified with the Company's 3-factor allocations justify a more intensive review of Corporate Group allocations than can occur in a rate case. I strongly urge the Commission to consider developing more specific allocation factors for each functional area of the Company.

Now is a perfect time to prescribe such analyses, since the Company has commenced its efforts to integrate administrative functions with ScottishPower. The merger is likely to significantly change and

expand intercompany dependencies and the sharing of administrative employees and costs. The merger is therefore also likely to create even greater regulatory concern about the sharing of corporate costs in the future. By carefully designing a more accurate and defensible cost assignment and allocation system for shared corporate administrative costs, coincident with the organizational planning and integration of the two Companies, it will be possible to completely explain and better justify requested shared cost recovery in regulatory proceedings while lessening the risk of regulatory disallowance. The results of such analysis need not be completed until the first rate cases occur in the post-merger environment. Another option may be to for the Commission to require this work as part of the ScottishPower merger transition plan to be submitted six months after merger closing.

Q. How should the shared corporate administrative cost assignment and allocation analysis you describe be conducted?

A. The Company should be directed to retain independent consultants to evaluate the nature and scope of all planned shared administrative functions in the post-merger environment and then assist the Company in the design and implementation of appropriate cost attribution policies and practices for all such functions and the related costs. This evaluation and process design effort should be responsive to guidance from the Commission, provided in its Order in this Docket, with regard to policies to be encouraged in the development of acceptable shared administrative cost attribution/ allocation practices. The results of this evaluation and development effort could either be submitted for joint review by the Utah and other state commissions or, at the option of the Company, simply presented as evidence in future rate case proceedings in support of test period expenses charged to Utah operations.

Q. What forms of authoritative guidance would be appropriate for the Commission to refer to in its Order compelling PacifiCorp to undertake such an evaluation?

A. There is no single generally accepted methodology that can be cited. Therefore, I have included in Attachments to this testimony copies of documents that I believe represent authoritative guidance in this area. I encourage the Commission to express its views with regard to cost allocation policies in its order in this Docket.

First, I recommend that the Commission direct the Company and its consultant to explicitly consider the Cost Allocation Guidelines for the Energy Industry that were adopted by the National Association

of Regulatory Utility Commissioners ("NARUC") by resolution of its Board of Directors on July 23, 1999. This document is contained in CCS Exhibit 5.1 to this testimony. Particularly relevant to the issues involved in allocating corporate costs are the "COST ALLOCATION PRINCIPLES" set forth at section B of this document.

The second source of authoritative support I recommend be considered is codified in Title 47, of the Code of Federal Regulations dealing with telephone regulation and cost allocations between regulated and non-regulated business segments. CCS Exhibit 5.2 to this testimony is a copy of excerpts from the Allocation of Costs rules prescribed by the Federal Communications Commission at 47 CFR § 64.901. The FCC's rules require cost allocation between regulated and non-regulated business functions focus first upon direct assignment, then any "common costs" that cannot be directly assigned are to be allocated based upon a hierarchy:

1) Whenever possible, common cost categories are to be allocated based upon direct analysis of the origin of the costs themselves;
2) When direct analysis is not possible, common cost categories shall be allocated based upon an indirect, cost-causative linkage to another cost category; and,
3) When neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities.

Finally, I would remind the Commission that U S West Inc. provides centralized administrative and corporate support services on an allocated cost basis and the procedures and costs of such services were the subject of a comprehensive regulatory audit in 1992. CCS Exhibit 5.3 contains excerpts from the executive summary of this audit, with a summary of "Evaluative Criteria" that were adopted by the U S West Regional Oversight Three-state Steering Committee for purposes of this project. Each of the evaluative criteria are set forth in the boxed text starting on page 7 and represent statements of guidelines or objectives to strive for in accounting for centralized administrative and management organizations. Of particular relevance to any review of PacifiCorp Corporate Group activities and costs are the following Evaluative Criteria stated in this audit of U S West, Inc.:

- Organization and management structures should ensure that products and services are not duplicated within U S WEST, Inc. and U S WEST Communications.

- The direct billing and allocations methodologies used by U S WEST, Inc. and U S WEST Communications should be founded upon reasonable and fair factors and bases that

properly reflect the value of products and services received, and should be supported by automated systems that provide management with the information and data it needs for not only recordkeeping, but also managing these activities.

- Cost allocation methodologies should appropriately separate costs between regulated and unregulated, with the regulated costs also separated by state jurisdictions.
- The costs for advertising, lobbying, antitrust, and contributions should be separable from other charges and handled in accordance with the applicable regulatory requirements.

This regulatory audit offers valuable insight into the kinds of issues that should be addressed prior to any future post-merger proceeding in which corporate costs are included for cost recovery.

Q. Are you recommending that the Commission adopt any of these cost allocation guidelines for application beyond PacifiCorp's shared administrative costs?

A. I believe that these guidelines are generally applicable and relevant to cost allocations employed by any utility and should be employed by PacifiCorp, except where departures from these guidelines can be justified with substantial evidence. The consultant retained by PacifiCorp should be directed to consider and address the applicability of each of these criteria for potential applicability to the services and costs in question. However, this testimony is not intended to initiate formal consideration of generic policies for application beyond PacifiCorp at this time or in this Docket. It is my understanding that the Commission has received Comments from the Committee of Consumer Services with respect to potential generalized rules associated with utility cost allocations outside of this Docket.

Q. Should the Company be allowed to defer the out-of-pocket non-labor costs it incurs to conduct the analysis you propose?

A. Yes. I would support the recovery of reasonably incurred costs for this effort in a future Utah rate case.

Q. Have other utilities undertaken similar evaluations of their affiliate relationships and shared corporate costs, in your experience?

A. Yes. It is not unusual for regulators to mandate detailed inquiries into utility centralized service organizations, to assure that the costs charged into regulated operations are reasonable.

RECLASSIFICATION OF PRESIDENT SALARY / EXPENSE

Q. What is the purpose of adjustment set forth in CCS Exhibit 5.1?

A. This adjustment is proposed to reclassify 25 percent of the test period allocated costs of the PacifiCorp President/CEO cost center below-the-line. It is based upon the fact that the Company's President/CEO is involved in the conduct of corporate development activities, including mergers & acquisitions, divestitures and other diversified business activities that are not properly allocated on a 3-factor basis to domestic electric operations. In large measure, the adjustment is based upon the same premise that caused the Company to propose the same 25 percent reclassification in the prior rate case, even though such an adjustment was not proposed by PacifiCorp in this Docket. The premise of the Company's adjustment in the prior rate case, which is the premise of the Committee's adjustment in this case, is that the existing exception time reporting systems used by PacifiCorp fail to fully account for the time spent by the President/CEO on corporate development matters.

Q. Did the Company acknowledge the failure of its direct charging systems in the prior rate case, by adjusting the recorded test period Corporate Group labor hours and costs downward for under-reported time spent on specific projects that should have been directly charged?

A. Yes. In Docket 97-035-01, PacifiCorp proposed a ratemaking adjustment to attempt to account for a "non-regulated" portion of the President's time and benefits (Adjustment 4.14). In that rate filing, PacifiCorp recognized the problems associated with the absence of time reporting by senior management and corrected the problem by simply assuming that 25 percent of the President's activities and costs should be reclassified below-the-line for "labor charges for some of the work performed on non-regulated activities [that] were not removed from Electric Operations' books." Apparently, this problem is ongoing, since direct labor charging to the ScottishPower merger project again seems so obviously understated.

Q. What is the basis for your conclusion that the accounting for the President's time spent on corporate development activities, in particular the ScottishPower merger, is understated?

A. The confidential Attachment to Committee Data Request 18.7 indicates [redacted]

[redacted]

[redacted] According to the Notice of Annual Meeting and Joint Proxy dated May 6, 1999 at pages 30 through 35, numerous meetings involving the Company's senior executive management and its Board of Directors occurred starting in early July 1998, culminating in the execution and public announcement of the merger agreement on Monday

morning, December 7, 1998. For the entire year 1998, the total labor hours and costs charged to the ScottishPower merger by the PacifiCorp CEO was only [redacted] The Committee's proposed adjustment is likely to be extremely conservative in only restating for the President/CEO time that was under-reported for charges to the merger project. I have included, as CCS Exhibit 5.8, copies of relevant pages of the Joint Proxy.

Q. What percentage of the total labor charges in the President/CEO function were charged to any specific project or to any corporate affiliate?

A. According to the Company's response to CCS 18.1, less than one percent of the President/CEO labor in the test period was charged to any project or separate entity, even though several major M&A transactions were planned, consummated or abandoned during the course of the year. This means that over 99 percent of the labor costs for the President/CEO were charged by 3-factor allocation.

Q. Who was the President of PacifiCorp in the 1998 test period?

A. In the first eight months of the year, Mr. Fred Buckman was the President. On August 26, 1998, PacifiCorp announced Mr. Buckman's departure from PacifiCorp and appointed Mr. Keith McKennon, then Chairman of PacifiCorp's Board, to the additional position of President and Chief Executive Officer. Both Messrs. Buckman and McKennon are reported to have discussed interests in business combination transactions with ScottishPower representatives in the Joint Proxy.

Q. Is your 25 percent reclassification a reasonable estimate of the ongoing portion of the President and CEO's time and expenses that should be retained by the Company to account for ongoing involvement in corporate development activities?

A. I expect that a 25 percent below-the-line retention of President/CEO costs is a conservative estimate of the time actually spent investigating and discussing strategic issues, opportunities and plans with management and the Board that do not directly relate to the management and oversight of the existing portfolio of PacifiCorp businesses. In the last case, I proposed a larger retention percentage than the Company's 25 percent adjustment. At this time, I am proposing a 25 percent retention so as to recognize the adjustment that was made by the Company and approved by the Commission in the last rate case.

STOCK-BASED INCENTIVE COMPENSATION

Q. What is the purpose of the Committee's adjustment at CCS Exhibit 5.4?

A. This adjustment eliminates the expenses recorded by Corporate Group in the test period related to stock-based incentive plans for executives of PacifiCorp. I recommend that shareholders, rather than ratepayers bear the costs associated with stock-based incentive plans and the adjustment I propose eliminates such costs from the Company's revenue requirement. The Company proposed its own Adjustment 4.3 in an apparent attempt to eliminate stock-based incentive compensation expenses, but the amount of the Company's adjustment is understated.

Q. What are the stock-based incentive plans that you recommend be excluded in determining revenue requirement?

A. The PacifiCorp Long Term Incentive Plan, PacifiCorp Stock Incentive Plan and certain Stock Option Agreements have been established by the Company to align the interests of Company management with shareholders' interests. In general, these plans provide for the award of restricted stock to officers and senior management, that vests over a four year period. Expense is accrued on the Company's books pursuant to this vesting schedule.

Q. What was the amount of test period expense recorded for stock-based compensation plans?

A. According to the Company's response to CCS Data Request 2.28, executive stock compensation expenses totaled $2.58 million in 1998, prior to allocation among PacifiCorp business entities and states. Most of this amount is associated with amortization of the acquisition costs of stock awarded to individual executives, spread over the vesting schedules contained within the stock-based compensation plans.

Q. For what reasons should stock-based incentive compensation costs not be included within the regulated rates of public utilities?

A. As noted above, the purpose of stock compensation is to align the interests of management with the interests of shareholders. This causes financial performance to become the only yardstick by which

results are evaluated. Exceptional earnings and cash flow can produce additional compensation to executive management under these plans, even if service quality or the price of energy to customers does not justify additional compensation funded by ratepayers. There is no measurement of customer satisfaction, service quality performance or cost of service performance in the awards granted under these plans.

Another concern with stock-based compensation is the inherent inconsistency involved in rewarding executive management for growth in earnings and stock price in an industry that presently has cost-based rates and designated service territories and markets. With regulated service prices targeted at producing equity returns approximately equal to the cost of equity capital, the only way to produce exceptional financial results in the regulated business units is to emphasize or subsidize non-regulated business ventures, deceive or distract regulators and/or profit from regulatory lag.

Notably, PacifiCorp's stock price and financial performance include the consolidated results of its diversified business portfolio, as well as gains and losses from mergers, acquisitions and divestiture transactions of the parent. As such, stock-based compensation may incent corporate management to focus upon those business segments with the largest potential financial reward to shareholders.

Finally, stock-based compensation tends to reward or punish participating employees based upon financial market conditions, without regard to their relative performance in managing the utility. In a "bull" market, where price/earnings multiples are relatively high and market to book ratios exceed unity, rewards may accrue without justification. In the capital intensive electric utility industry, general trends in interest rates can impact stock prices without regard to management effectiveness. Utility ratepayers should not, in my opinion, be responsible for the costs of stock-based management performance compensation arrangements that are aligned with shareholder interests but not linked to utility service costs, rates or service quality.

Q. Are these the same stock-based compensation plans that were excluded by the Commission in the Company's last rate case?

A. Yes. In its Order in Docket No. 97-035-01 issued March 4, 1999, the Commission stated:

> In Docket No. 95-049-05, the US West Communications, Inc. rate case referenced above, we determined that an incentive plan must have customer service not financial goals as its primary purpose if expenses are to be recovered

in regulated utility rates. We concluded that financial goals may be achieved at the expense of customer service. In other words, rather than being a question of whether the plan harms ratepayers, as the Company puts it, the issue if one of ratepayer benefit. No evidence on this record leads us to conclude that the Company's LTIP meets this test. The Company raises no new issues and offers no new evidence of a sort not previously considered. Though we look for an objective demonstration by the Company that its plan benefits ratepayers, we find only the qualitative assertion that efficient operations, strong leadership, and share price performance does so. Accordingly, we reject the test recommended by the Company for recovery of incentive plant expenses. We find that the difference between the Division and Committee adjustments is due to the corporate overhead allocation factor. Since we have accepted the Divisions's update of this factor, we conclude that the adjustment proposed by the Division in appropriate and should be adopted. This decision increases ratemaking income $229,630.

As noted above, it appears that the Company has consented to this adjustment and the remaining difference involves only quantification of the proper adjustment.

Q. Does the adjustment you propose prevent PacifiCorp from continuing to grant restricted stock or stock options to attract and retain management personnel?

A. No. The effect of excluding stock compensation program costs from revenue requirements is to cause such costs to be borne by shareholders. The Company's Board of Directors can continue to evaluate whether superior earnings, cash flow and other measures of total return to shareholders justifies continuation or expansion of stock compensation programs and whether such programs are in the overall best interests of investors.

CORPORATE STRATEGIC CONSULTING EXPENSES

Q. What is the purpose of the Committee's adjustment at CCS Exhibit 5.2?

A. This adjustment removes from the test period cost of service certain corporate group strategic consulting and investment banking fees that do not relate to domestic electric operations, produce no tangible benefit to Utah ratepayers and appear to be unusual and non-recurring in nature. Detailed vouchers supporting these costs were produced in response to CCS Data Request 18.10, but the Company has not provided the requested explanations for the business purpose and any ratepayer benefits associated with these expenditures. In that some of the costs appear to be related to corporate M&A projects and the reformation of the Company's overall strategic plans, it is most appropriate that such costs not become embedded in ongoing expenses underlying Utah rates.

Q. Did these consulting charges cause large variances in Corporate Group expenses, relative to budgeted costs expected in each responsibility center?

A. Yes. The Chief Financial Officer ("CFO") corporate group function incurred actual charges of $3.3 million in 1998, which exceeded the budgeted expenses of $2.5 million by about $800,000. The Company's response to CCS Data Request No. 2.8 explained this variance as, "Outside services for Centralia sale". In another response (CCS 2.28), the total variance for the CFO was broken down in greater detail, indicating that outside services were actually $1.5 million over budget, but favorable variances in salaries and other costs tended to offset the large unanticipated spending for outside services by the CFO. This variance result provides additional indication that test period outside services costs in the Corporate Group were abnormally large and should be adjusted.

Q. What are the individual transactions and amounts included in your adjustment?

A. The individual line item detail is set forth in the footnote included in CCS Exhibit 5.2.

Q. Is your proposed adjustment subject to change, if additional information is produced by the Company to justify cost recovery for these transactions?

A. Yes. However, the Company should explain not only the nature and purposes for each transaction, but should also explain and illustrate the benefits to electric operations' customers, as well as supporting the conclusion that such activities and costs are normal, ongoing expenses properly included in Utah revenue requirement.

CORPORATE AIRCRAFT ANNUALIZATION

Q. Please explain your final adjustment, as set forth in CCS Exhibit 5.3.

A. Pacificorp Trans, Inc. is a corporate affiliate that owns and operates a fleet of aircraft that are used to transport Company employees. The direct costs of aircraft operations are recovered through two charges, a direct charge to departments or affiliate entities at equivalent commercial fare levels for actual usage by employees in that department, and a residual charge to allocate the significant remaining costs not recovered through the direct charges. Late in 1998, PacifiCorp reduced the size of its aircraft fleet by selling its Citation X. This sale and permanent downsizing of the fleet created an ongoing cost savings associated with residual fixed expenses that are now avoided. The Utah electric

operations' share of such savings is quantified in the Committee's adjustment.

Q. Does the Company dispute that such an adjustment is appropriate?

A. Apparently not. In its response to CCS Data Request No. 18.19, the Company described the changes to its aircraft fleet and conducted an analysis of its corporate aircraft costs based upon an assumed "redistribution of the hours flown by the Citation X" and concluded that "a reduction of $174,901 on a Utah-allocated basis" should result.

Q. Why is the adjustment you propose larger than the Company's proposed adjustment amount?

A. The Company's adjustment would re-allocate all of the flight hours and miles from the sold aircraft as if the total amount of travel will be unchanged, so as to factor up the indicated cost of the smaller fleet. This approach fails to properly account for the avoidable fixed costs of downsizing the fleet.

Q. Does this conclude your direct testimony?

A. Yes.