Witness CCS - 1
Exhibit CCS-1

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	)	**HUGH LARKIN, JR.**
and Electric Service Regulations	)	**FOR THE COMMITTEE OF**
	)	**CONSUMER SERVICES**

February 4, 2000

NON-CONFIDENTIAL

TABLE OF CONTENTS

INTRODUCTION

OVERVIEW

ADJUSTMENTS RECOMMENDED

Glenrock Mine Closure
Software Obsolescence Cost
Computer Mainframe Write-Down
Re-Engineering Costs
Condit Dam Removal Costs
Business Systems Integration Project (BSIP)/Systems Application Product (SAP)
Imputed Revenue For Western Area Power Administration
Organization Costs
Y2K Adjustment
Customer Service System Disallowance
Unbilled Revenue
Line Extension Revenues

INTRODUCTION

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. My name is Hugh Larkin, Jr. I am a Certified Public Accountant licensed in the States of Michigan and Florida and the senior partner in the firm of Larkin & Associates PLLC, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES.

A. Larkin & Associates PLLC is a Certified Public Accounting and Regulatory Consulting firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin & Associates PLLC has extensive experience in the utility regulatory field as expert witnesses in over 400 regulatory proceedings including numerous water and sewer, gas, electric and telephone utility cases.

Q. HAVE YOU PREPARED AN APPENDIX WHICH DESCRIBES YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Appendix I, which is a summary of my experience and qualifications.

Q. BY WHOM WERE YOU RETAINED, AND WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. Larkin & Associates PLLC was retained by the Committee of Consumer Services (CCS or Committee) to analyze PacifiCorp's dba Utah Power & Light Company's (UP&L or Company) rate case filing for the test year ending December 31, 1998, and to make recommendations to the Utah Public Service Commission (Utah Commission) based on that analysis.

I will be presenting the Committee's overall revenue requirement recommendations based on the analysis of Larkin & Associates PLLC and other consultants retained by the Committee. These recommendations are based on an analysis of the test year ended December 31, 1998, applying the policies and principles of utility ratemaking utilized by the Utah Commission in establishing rates.

Q. PLEASE DISCUSS WHICH ISSUES WILL BE SPONSORED BY YOUR FIRM AND THOSE TO BE SPONSORED BY OTHER COMMITTEE CONSULTANTS.

A. The summary of the Committee's overall recommendation is shown on CCS Exhibit 1.1, page 1 of 3. The exhibit is a summary of rate base and operating income adjustments which are shown on CCS Exhibit 1.1, page 2 and 3 of 3. On CCS Exhibit 1.1, page 2 of 3, each rate base adjustment is shown with the particular witness responsible for that rate base adjustment identified in the column under the heading of consultant. On CCS Exhibit 1.1, page 3 of 3, the adjustments to operating revenue, operating and maintenance expenses, depreciation and amortization, and taxes are shown. Again, next to each adjustment, the witness responsible for that adjustment is identified. Each witness' testimony will discuss the adjustment they sponsor and identify why the adjustment is appropriate for establishing rates for PacifiCorp's Utah operations.

The summary of CCS Exhibit 1.1, on page 1 of 3, indicates that rates should be reduced by a net amount of $23,892,651 prior to reflecting the impact of Committee Witness Tony Yankel's recommendations. After consideration of the impact on revenue requirement resulting from Mr. Yankel's recommendations, rates should be reduced by $36,476,451, as shown on line 11 of Exhibit 1.1, page 1.

OVERVIEW

Q. IN PACIFICORP'S FILING, MR. RICHARD T. O'BRIEN ATTRIBUTES THE NEED FOR A RATE INCREASE TO GROWTH IN CAPITAL EXPENDITURES IN THE UTAH JURISDICTION. WOULD YOU PLEASE COMMENT ON THAT EXPLANATION OF THE PROPOSED RATE INCREASE?

A. Our review and analysis of the documentation obtained from UP&L indicates that the primary reason the Company's filing has been made is a failure to control non-fuel operations and maintenance costs and general administrative costs. During the last several years (1995 to 1998), PacifiCorp management was not focused on its domestic electric operations. It is this underlying deficiency in the Company's operations and management which motivated it to author the voluntary enhanced retirement and severance package to those employees eligible for that program. In addition, the Company has taken steps to reduce other costs in 1998. However, even with the cost cutting initiatives taken by the Company in 1998, the Company still budgeted a 2% increase in expenses over 1997.

Q. HOW DOES PACIFICORP'S NON-FUEL OPERATING AND MAINTENANCE COSTS COMPARE TO THE PEER GROUP WHICH IT COMPARES ITSELF TO?

A. On CCS Exhibit 1.2, page 1, I have attached a graph which was in the Company's January 19, 1998 employee publication titled "Network". This graph shows that PacifiCorp's non-fuel O & M expenses

have increased by 8.70% during the period 1995 to 1997 while the peer group decreased by 0.50% during the approximate same period. This results in a 9.2% gap between PacifiCorp's performance and that of its peers as of 1997. This relationship would have continued in 1998, since the Company's budget for 1998 increased by 2% above the prior year's budget.

Q. WHAT DID PACIFICORP'S FORMER CEO AND PRESIDENT, FRED BUCKMAN, ATTRIBUTE THE FACT THAT PACIFICORP'S COSTS WERE OUT OF LINE WITH THE PEER GROUP TO?

A. In the January 19, 1998 Network article (see CCS Exhibit 1.2, page 3), Mr. Buckman was quoted as saying, "...he didn't think the Company had been as disciplined or pushed as hard to control its costs as some of its peers had." In discussing the proposed initiatives to reduce costs, he also stated, "If we're not successful, if we fall back into a utility mentality of complacency, we'll have to do this again." PacifiCorp's former CEO admitted that the Company had been complacent and not actively controlling costs.

Q. WERE THERE OTHER EXPLANATIONS IN THE COMPANY'S NEWSLETTERS TO ITS EMPLOYEES WHICH EXPLAINED IN MORE DETAIL WHY THE COMPANY'S COSTS WERE OUT OF LINE WITH ITS PEERS?

A. Yes, there were. A February 2, 1998 interview of the former Controller, Mr. Huesgen is particularly illustrative. According to Mr. Huesgen:

> While power supply costs have remained relatively flat over the last five years, he said, PacifiCorp has experienced significant increase in general administrative expenses at a time when the Company is also experiencing decreases in the margins on its wholesale sales.
>
> In 1997, compared to 1996, contract and outside services were up 35 percent, employee business expenses were up 19 percent, utility expenses increased 46 percent, and postage was 13 percent higher. The number of employees increased by 5 percent. The business systems integration project and the Year 2000 software conversion projects are part of the equation too.

The article continued, stating as follows:

> Last week, PacifiCorp's board of directors approved a 1998 budget that includes plans for some aggressive initiatives to rein in those costs. Still, the 1998 budgeted non-fuel costs are expected to increase approximately 2 percent over last year's budget.

The full text of this article is included as CCS Exhibit 1.2, page 4.

Q. WAS PACIFICORP SUCCESSFUL IN REDUCING ITS COSTS SUCH THAT ITS EARNINGS IMPROVED?

A. No, it was not. In its November 2, 1998 employee newsletter Network, the new chairman who replaced Mr. Buckman, Keith McKennon, continued to call for additional cost reductions. The November 2, 1998 article stated that the chairman "...outlined the need for the change and cost reductions to achieve an annual pre-tax savings of $30 million." Specifically:

> Success in the West will be the platform for building shareholder value. By refocusing on the business we know best, I believe we can achieve our five year target of 5 percent average annual growth in earnings per share, beginning in 2000.

He continued discussing the need to cut overhead costs, stating "We will be reducing our workforce in our ongoing business significantly."

He continued:

> We are working on it now, and will finalize the specifics soon. These actions will be completed by the end of the year.

Further in the article, he stated as follows:

> We expect reductions will come from all levels of staff, wherever they may reside. Unfortunately, it's likely layoffs will occur, although we are also looking at extending to those employees impacted by the reduction the early retirement offering made earlier this year." (See CCS Exhibit 1.2, page 5)

Q. ARE THE COST SAVINGS DISCUSSED BY MR. MCKENNON REFLECTED IN THE TEST YEAR?

A. Obviously, all of these new reductions have not been reflected in the 1998 test year actual results. Moreover, significant adjustments to the test year are necessary. The test year includes inflated costs, and the rate filing itself includes pro forma adjustments similar to those offered in the Company's last rate filing, which mismatched costs with benefits. These adjustments will largely be discussed by Larkin & Associates PLLC witnesses in our respective testimonies.

Q. WHAT DID CEO KEITH MCKENNON CONVEY TO WALLSTREET ANALYSTS REGARDING THE IMPLEMENTATION OF OVERHEAD COST REDUCTIONS?

A. On April 2, 1999, in the Company's renamed newsletter, "PacifiCorp Today," CEO McKennon indicated to Wallstreet Analysts that the Company had "Implemented an overhead cost reduction program designed to save $30 million annually in pre-tax operating costs." (See CCS Exhibit 1.2, page 6). According to the response to CCS 24.19, the cost reductions are estimated at $30.8 million with $13.4 million attributable to salaries and the remaining $17.4 million attributable to non-salary reductions. While the filing does include an adjustment to reflect some of the employee related savings in the workforce reduction adjustment, it does not reflect the non-employee related cost savings. Obviously, if the Company had just implemented the program in late 1998 and did not adjust for the non-employee savings, those cost reductions could not have been realized in the 1998 test year. It is clear that the Company's filing still reflects costs which should not be included in rates.

The excessive and overstated costs, plus the inclusion of adjustments in the Company's filing which

are out of period and do not match cost with the benefit result in a test year which is inappropriate for the establishment of base rates unless significant adjustments are made.

ADJUSTMENTS RECOMMENDED

Glenrock Mine Closure

Q. THE COMPANY, THROUGH WITNESS DALLEY, CLAIMS THERE HAVE BEEN CHANGES IN THE OPERATION OF THE GLENROCK MINE IN 1998 WHICH SHOULD RESULT IN THE START OF THE AMORTIZATION OF ANY CLOSURE COSTS IN THAT YEAR. DO YOU AGREE WITH HIS ANALYSIS?

A. No, I do not. The coal being provided for the operation of the Dave Johnston plant is coming from the Glenrock mine. The mine continued to operate and provide coal for operation of that plant through all of 1998 and was projected to continue to operate through October 1999. Coal from the Glenrock mine would be stockpiled at the mine for use during the rest of 1999 and beyond, if needed.

Q. DO YOU THINK THAT THE INCREASE OR DECREASE OF THE COAL COSTS BEING PRODUCED BY THE GLENROCK MINE HAS ANY EFFECT ON HOW THE COMMISSION SHOULD VIEW THE COMPANY'S PROPOSED ADJUSTMENT?

A. No, I do not. The benefit of the closure of the mine will clearly come in the year 1999 and beyond. This is when the new rail unloading facility will be available and the actual operation of the Glenrock mine will terminate. This termination was projected to occur in late 1999 or early 2000, which is clearly well beyond the 1998 test year. To start to amortize any abandonment loss in 1998 would match higher expenses for this abandonment loss with fuel costs associated with continued operations of the Glenrock Mine. The benefit of the mine closure will come from the purchase of lower cost coal from the Powder River Basin market beginning in late 1999 or early 2000.

As I previously stated in Docket No. 97-035-01, this entire event is post-test year. Post-test year adjustments are excluded by the Utah Commission, and correctly so. This is an attempt by the Company to mismatch costs and benefits.

Q. HOW WILL THAT BE?

A. The 1998 test year uses normalized fuel costs as produced from the Glenrock mine. If the amortization costs are also included, then rates will be set at a higher level both for the fuel cost and the amortization of a mine closure which has not actually occurred. In 1999 or 2000, when the actual mine closure occurs and fuel costs decrease below that of the Glenrock mine because coal purchases will be from the Powder River Basin market, the lower fuel costs will benefit only the Company. Rates will be set based on the Glenrock mine fuel costs, which will be higher then those from the Powder River Basin. Thus, ratepayers will pay the higher fuel costs in rates, but the Company will pay lower fuel costs in 1999 or 2000, when the new offloading facility and the purchases from the Powder River Basin market actually reduce costs.

Q. MR. DALLEY ALSO CLAIMS THAT THE PROPER ACCOUNTING FOR THE GLENROCK MINE IS TO ACCRUE THE RECLAMATION COSTS BEFORE THE MINE IS CLOSED, AND THAT AMORTIZATION OF THE CLOSING COSTS STARTING IN A 1998 TEST YEAR WOULD BE MORE IN LINE WITH THE COMMISSION POLICY FOR RATEMAKING PURPOSES. DO YOU AGREE WITH THAT STATEMENT?

A. No, I do not. In the prior docket, the Company claimed that the additional reclamation cost, which was accrued in the 1997 write-off of approximately $33 million, was the result of closing the mine early rather than a failure to use the proper accrual rate for reclamation costs. If that statement is true, then

the entire cost of closing the mine estimated by the Company at $64 million is an abandonment losses occasioned by the early closing of the mine. Most abandonment losses are amortized over some future period and not accrued prior to the abandonment.

Q. IN THE PRIOR DOCKET, YOU ALSO EXPRESSED RESERVATIONS REGARDING THE COMPANY'S STATEMENT THAT THE $33 MILLION ACCRUAL FOR RECLAMATION COSTS WAS OCCASIONED BY THE EARLY CLOSING OF THE MINE. DO YOU STILL HAVE THOSE CONCERNS?

A. Yes, I do. The Company has told its external auditors that its accounting policy is to accrue an expense as an addition to a reserve for "future" or "final" reclamation. This reserve is to provide for reclamation of the final high wall and other mine closure costs, including removal of mine facilities and recontouring, revegetation and restoring the land site to its natural habitat. This final reclamation is a liability for costs that relates to the entire ore tonnage that has been or will be mined at the site.

To provide for such reserve by matching the appropriate cost of the final reclamation to the coal mine, an extensive study is undertaken by the operator to determine what it will cost to perform the reclamation activities when the final high wall will be encountered. This cost is spread over the total tons of coal expected to be recovered at the site, and it is expensed as a cents per ton figure as coal is mined. Each year an amount is added to the reserve based on the tons of coal mined in the year in order to accrue the expense related to the final reclamation proportional to the entire ore body. At December 31, 1997, the Company had accrued $20,877,231 in this reserve. The adjustment made by the Company to this reserve for the early closure was $33,214,768. This increased the reserve by 159%. In other words, the Company claimed that if it had operated the mine to its original termination date, it would have accrued an additional $33.2 million of reclamation costs. The mine has been in

operation since 1958, some 41 years from its closure in 1999.

Q. WHAT DOES THAT INDICATE TO YOU?

A. This indicates that the accrual rate used by the Company was understated in prior years and that the $33 million is, in part, an attempt to make up an under accrual from prior years.

Q. WOULD THAT BE APPROPRIATE?

A. No, it would not. This would be retroactive ratemaking, which is illegal in most states in this country, and I believe it is illegal in Utah.

Q. HOW SHOULD THE COMMISSION SETTLE THIS ISSUE AS IT RELATES TO RECLAMATION COSTS IN A FUTURE RATE CASE WHICH USES A TEST YEAR IN WHICH THE MINE HAS ACTUALLY BEEN CLOSED?

A. The Commission should examine the relationship between the final reclamation cost accrual on the Company's books and its annual report to the State of Wyoming, Department of Environmental Quality, for the last several years. This report should include data on the final reclamation cost of the Glenrock mine. If the accrual on the Company's books is less than what the report to the Department of Environmental Quality is, and the Company did not adjust its accrual rate, then it would be apparent that the Company is engaging in retroactive ratemaking. If the report to the Department of Environmental Quality shows the same or similar amounts as the accrual, then the Commission could be assured that what it was reporting to the Wyoming Department of Environmental Quality was the same dollar amount that it was accruing on its books.

Q. WHY WOULDN'T THE COMPANY INCREASE ITS ACCRUAL AS THE ESTIMATED COST OF RECLAMATION INCREASED?

A. If the cost of reclamation increased and the Company increased its accrual, then the cost of fuel would go up, which would decrease the Company's earnings. By not recognizing the cost increases as fuel cost when the increases were occurring, the Company could then claim that the increased costs were part of the abandonment loss and recover these dollars from ratepayers at some future point in time. This would be inappropriate and should not be allowed by the Utah Commission.

Q. WOULD YOU PLEASE SUMMARIZE YOUR RECOMMENDATION AS IT RELATES TO THE GLENROCK MINE ISSUE?

A. There has been no substantial change in the Glenrock mine issue since the Commission's Decision on this matter in Docket No. 97-035-01. The Glenrock mine continued to operate through all of the 1998 test year and the major part of 1999. It is expected to be a backup for coal supplied to the David Johnston Plant until the coal unloading facility is placed in service and proven to be reliable.

The Company's adjustment for the Glenrock Mine is clearly a post-test year adjustment and does not follow the Commission's test year policy. In addition, serious questions remain regarding whether part of what the Company is requesting is, in fact, retroactive ratemaking. Until the Company can substantiate that what it accrued on its books matched what it told the Wyoming Department of Environmental Quality related to the final reclamation costs, then it would be inappropriate to approve these costs for ratemaking purposes. Clearly, any potential benefit that flows from closing the Glenrock mine will occur in the future when the Powder River Basin coal supply contracts affect the fuel costs at the David Johnston Plant.

Q. DO YOU HAVE ANY INDICATION WHAT THE NET SAVINGS WILL BE WHEN THE GLENROCK COAL MINE IS CLOSED?

A. The January 26, 1998 Network newsletter stated:

> The closure of the mine is expected to result in annual pre-tax cost savings of approximately $15 million after final mine closure.

Even if you were to accept Mr. Dalley's claim that savings are currently flowing from the mine operations they would not approach $15 million.

Q. APPROXIMATELY WHAT WOULD THOSE SAVING BE?

A. I am informed that current rates (Docket No. 97-035-01) include full cost from the Glenrock mine of $8.44 per ton. If you ignore the early out employee costs, as Mr. Dalley has, Glenrock fuel costs would be $8.02, or a savings of .42 per ton. Coal delivered in 1998 from Glenrock was 4,030,727 tons. A saving of $1,692,905 would result (4,030,727 x .42 = 1,692,905). The early out employee costs were $4,545,714, which far exceeds the savings.

Software Obsolescence Cost

Q. THE COMPANY IS AGAIN RECOMMENDING IN THIS CASE THAT THE COMMISSION ADOPT A WRITE-OFF AND THREE YEAR AMORTIZATION OF SOFTWARE PROGRAMS WHICH THE COMPANY CLAIMS WILL BE REPLACED BY SAP SOFTWARE. DID SUCH REPLACEMENT OF THESE SOFTWARE PROGRAMS OCCUR IN 1998?

A. No, they did not. The Company continued to use its old software programs throughout 1998 for its accounting system and resource planning systems. During 1998, the Company's Information Technology Department, along with its consultants, were engaged in the configuration phase of integrating the Business Systems Integration Project (BSIP)/Systems Application Product (SAP) systems to the Company's environment. These costs were capitalized as part of the design and implementation phase of the BSIP/SAP project. The phase-in of the use of BSIP/SAP started January 11, 1999, when the first major component of the SAP R/3 software was made available to 2,700 power

supply and corporate employees.

Q. MR. DALLEY TESTIFIED IN DOCKET NO. 97-035-01 THAT SAP WAS IN USE IN CERTAIN NON-REGULATED AREAS AND AT THE NAUGHTON PLANT IN 1998. IS THAT CORRECT?

A. Yes. In September 1998, a pilot implementation project was undertaken at the Naughton Plant and at PacifiCorp Group Holding (PGH). Pilot projects are utilized to work out bugs in systems prior to implementation by other departments of the Company. The January 15, PacifiCorp Today employee's newsletter states, in part:

> About 275 users at Naughton and PacifiCorp Group Holding (PGH) began using a limited release of SAP in September then expanded to the current release in December.

The accounting systems which the Company seeks to write-off in this rate case were utilized all of 1998 with the SAP system being phased-in during 1999. Even at the pilot project locations, the old systems were utilized subsequent to September 1, 1998. As stated in the PacifiCorp newsletter, Network, of August 31, 1998:

> Existing systems, such as materials management (MRPS) for Naughton and Oracle for PGH, will not go away Sept. 1, but all new transactions will then be handled in SAP at those locations.

The article continues and states:

> The Sept. 1 implementation (Release A) is the first in a series of implementations scheduled throughout the Company. Release B begins January 1999 and includes all staff organizations, the financial organization, TPC, all remaining plants and global, sales marketing and energy trading. Customer operations is scheduled to go live April 1999 and the mines will follow in July 1999.

Q. DID THE COMPANY KEEP THE APRIL 1999 IMPLEMENTATION DATE FOR THE SECOND ROLLOUT?

A. No, they did not. The February 16, 1999, Company newsletter states that the date was pushed back to May 10 so that the Company could focus on quality implementation and provide more time for employee training. Clearly, the implementation and additional training in 1999 could not have benefitted productivity in 1998.

Q. WHEN WAS THE NEXT LARGE GROUP OF EMPLOYEES ADDED TO THE SAP SYSTEM?

A. On May 10, 1999, 2,000 employees had the SAP system available for their use. This is detailed in the May 14, 1999, employee newsletter. The newsletter indicates that the deployment was to all parts of PacifiCorp except mining, which would not be added until after 1999. Thus, although the Company has claimed that the SAP system was implemented in 1998, it is clear that all of the implementation, with the exception of a small pilot project, occurred in 1999 and beyond.

Q. WHAT DOES THIS MEAN AS IT RELATES TO THE PROGRAMS WHICH THE COMPANY WISHES TO AMORTIZE BEGINNING IN 1998?

A. This means that the programs actually were utilized throughout 1998 by all operations of the Company.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. I have reversed the Company's amortization of this software write-off and added the required amount to rate base to reflect the proper investment which ratepayers should pay a return on. This adjustment is presented on CCS Exhibit 1.4.

Q. WHEN SHOULD THIS SOFTWARE BE AMORTIZED AND RECOVERED IN RATES?

A. I discuss the proper period to amortize this software in the BSIP/SAP section of my testimony.

Computer Mainframe Write-Down

Q. AS IN THE PRIOR CASE, DOCKET NO. 97-035-01, THE COMPANY IS REQUESTING AN AMORTIZATION OF THE COMPUTER MAINFRAME WRITE-DOWN. WHAT IS YOUR RECOMMENDATION REGARDING THIS PROPOSED ADJUSTMENT?

A. The amortization of the computer mainframe write-down is another adjustment the Company made in the 1997 rate case that is directly related to the installation of a new software program called SAP (System Application Product). As previously indicated in my discussion of the software write-down, these write-offs were directly related to the SAP programs and should be amortized during the time frame when the SAP programs are up and running and can be shown to be a net benefit to the Company and ratepayers. As I will discuss later in my testimony, and have indicated in my discussion of the software issue, the SAP programs were installed in segments throughout 1999. They, therefore, could not have provided any productivity benefits in 1998. The inclusion of the SAP related costs in the 1998 test year would violate the Commission's policy which matches costs with the proper period in which benefits are received. No benefits could have been received in 1998, as the Company essentially operated under its old computer programs and was developing BSIP which would be implemented through the SAP programs.

Q. MR. DALLEY SEEMED TO INDICATE THAT THE RETIREMENT OF THE OLD COMPUTER MAINFRAME AND THE INSTALLATION OF A NEW ONE IN JANUARY 1998 WAS RELATED TO OTHER COMPUTER PROGRAMS NOT SAP. WOULD YOU PLEASE COMMENT?

A. Mr. Dalley's statements fly in the face of what the Company told its stockholders both in its 1997 and 1998 annual reports. At page 50 of the 1997 annual report, when discussing special charges in note 5, the Company stated "...a $19 million write-off of certain information system assets associated with the Company's decision to proceed with an installation of SAP enterprise wide software..." In the 1998

report to stockholders, at page 28, the Company states the following in regard to the write-offs of the software and hardware which are at issue in this docket:

> In addition, the Company recorded a $19 million charge in 1997 for the impairment of certain information system assets ("IT systems") that were included in its property, plant and equipment balances. These IT systems <u>were retired as a direct result of the Company's installation of SAP enterprise-wide software</u>. (Emphasis supplied)

The $19 million is comprised of the computer mainframe write-down of $12,149,518 and software write-down of $6,945,601. These items total to $19,095,119, which is in agreement with the Company's footnote in its annual report to stockholders. It is clear that the computer mainframe write-down and the software write-down were the result of the Company's decision to implement SAP. The 1998 footnote clearly states that the IT systems were retired as a <u>direct result</u> of the Company's installation of SAP enterprise-wide software.

Q. WHY WOULD IT BE INAPPROPRIATE TO START THESE AMORTIZATIONS IN 1998, RATHER THAN WHEN THE SAP PROGRAMS SHOW PRODUCTIVITY BENEFITS?

A. Inclusion of the costs in the test year would violate the matching principle of utility ratemaking and this Commission's policies. If SAP can really show net productivity benefits, those benefits will occur when the programs are up and running (used and useful) in the Company's operations. This did not occur in 1998. If these costs are amortized in 1998, rates will increase because the potential benefits will only come in the future (i.e., outside the test period). Therefore, a mismatch of costs and benefits occurs which violates both normal ratemaking principles and this Commission's policies.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. As in the prior case, I recommend that the $12,149,518 be reinstated in rate base and the Company continue to earn a rate of return on those assets until the SAP programs are installed and the

Company can show a benefit to ratepayers from such programs. Since this did not occur in 1998, this is emanately fair both to the Company and ratepayers. The ratepayer will not have to pay an amortization on this mainframe computer without the supposed benefit of productivity gains which result from the SAP programs. On the other hand, the Company receives a return on this asset until such time it can show the SAP programs benefit ratepayers. My recommendation is presented on CCS Exhibit 1.5.

Re-Engineering Costs

Q. AS IN THE PRIOR CASE, THE COMPANY IS REQUESTING RATE BASE TREATMENT AND AN AMORTIZATION OF RE-ENGINEERING COSTS. WHAT IS YOUR RECOMMENDATION REGARDING THIS ISSUE?

A. The re-engineering costs are costs incurred by the Company in its preliminary analysis which proceeds the design and implementation of the SAP programs. As explained by the Company in response to a data request in Docket No. 97-035-01, the re-engineering process is the scoping, planning and business case for enterprise-wide process re-engineering in the areas of human resources, finance, material management and work management. This process determines what the Company's current system and processes are in the areas described and is known as the AS-IS analysis. This initial study is then utilized to design the TO-BE process which redesigns the flow of information in the areas of human resources, finance, material management and work management. The re-engineering process is all part of the BSIP, an enterprise-wide business process re-engineering project. The re-engineering process, in and of itself, results in no benefit to the Company, and thus, the ratepayers. The re-engineering process must be turned into the programs and systems which function through the SAP programs.

Q. YOU PREVIOUSLY INDICATED THAT THE SAP PROGRAMS WILL ESSENTIALLY AFFECT YEARS AFTER 1998. IS THAT CORRECT?

A. Yes. The re-engineering process cannot benefit ratepayers unless, and until, the time that SAP programs are fully functional and utilized by all segments of the Company's business. Even then, the costs may not produce the productivity gains which the Company anticipates.

Q. IS THE RE-ENGINEERING PROCESS AT THE COMPANY COMPLETED?

A. No, it is not. The Company incurred $10 million in costs in 1997. An additional $6,274,127 was incurred in 1998. In response to CCS Data Request 4.45, the Company indicated it has spent an additional $13,970,628.31 through November 1999, and projects to spend an additional $1,484,000 in December 1999, for a total 1999 cost of $15,454,628.31. The 1999 amount is almost double the expenditures through 1998. This indicates that the re-engineering of the Company's processes and the redesign of those processes is essentially ongoing into 1999 and beyond.

Q. IN OTHER WORDS, IF THE COMMISSION WERE TO APPROVE THE INCLUSION OF THIS BALANCE IN RATE BASE AND BEGIN AMORTIZING THESE COSTS, IT WOULD BE APPROVING THE RECOVERY OF THESE COSTS WITHOUT A CORRESPONDING BENEFIT TO RATEPAYERS. IS THIS CORRECT?

A. Exactly correct. Reprocessing engineering on its own creates no benefit. It is a preliminary stage to redesign and implementation through the SAP programs. Thus, without these programs being in place and providing benefits throughout 1998, re-engineering costs do not meet used and useful standards.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. As shown on CCS Exhibit 1.6, I recommend that the adjustment proposed by the Company be

reversed. The amortization should be excluded from test year expenses, and the expenditures should be excluded from rate base. This is consistent with the Commission's decision in the last case.

Q. WHY SHOULD THE BALANCE BE EXCLUDED FROM RATE BASE AND RECEIVE NO CURRENT CASH RETURN?

A. This is what the Commission decided was appropriate in the prior case. Additionally, this would be proper accounting and ratemaking policy. The balance in this account represents a project which is in progress and provides no current benefit to ratepayers and thus, should receive no current return provided by ratepayers. Furthermore, the Company could accrue an allowance for funds used during construction return (AFUDC) on this investment if it were appropriate to do so.

Q. MR. DALLEY, IN HIS TESTIMONY, CONCLUDES THAT THE CONCERNS EXPRESSED BY THE COMMISSION REGARDING THESE RE-ENGINEERING COSTS NO LONGER EXIST OR ARE SUBSTANTIALLY REDUCED. WOULD YOU PLEASE COMMENT?

A. First, Mr. Dalley claims that the benefits of the SAP program began in 1998. The only thing that occurred in 1998 was a pilot project at one plant with substantially all of the roll out of the SAP programs occurring in years subsequent to 1998.

Second, the Commission expressed concern that there was no review or analysis of the program benefits in the last case. That analysis is still missing from this case, as I will explain later in my testimony.

Next, the Commission expressed some concern about additional expenditures being incurred. As I previously indicated, the Company almost doubled its expenditures in 1999 from 1998 and 1997 levels

without any real analysis of what those costs are and what benefits ratepayers would receive in the current test year from these expenditures. The Commission also stated that US West's amortization of re-engineering costs were allowed, in part, as a result in the change in rate of return regulation and a price freeze. Mr. Dalley effectively states that this should not be considered in determining whether these costs should be amortized. I submit that Mr. Dalley missed the point in the Commission's statement of this fact. My understanding of the Commission's Order is that because of the change in regulation, these costs could not be included in any future proceeding as US West would no longer be subject to rate of return regulation. This is not the case with PacifiCorp, where the deferral of such costs can be considered by the Commission in a future rate case.

Lastly, Mr. Dalley states that the Commission did not allow a rate of return on US West's re-engineering costs because re-engineering played a role in US West's declining service quality and there was not sufficient evidence in Docket No. 97-035-01 to allow the Commission to decide whether this was the case for PacifiCorp. Mr. Dalley states that PacifiCorp had not experienced similar service quality problems and that the re-engineering costs consist of scoping and planning costs for SAP which is unrelated to service quality. I would point out that the Company has incurred significant cost increases related to the SAP programs and its normal operating costs. It has incurred significant operating cost increases during 1997 and 1998. The current CSS program, which was partially allowed in rates in 1997, is not functioning properly. Eventually these increased costs and poor cost controls will result in service quality problems.

Condit Dam Removal Costs

Q. THE COMPANY HAS INCLUDED IN DEPRECIATION EXPENSE APPROXIMATELY $2 MILLION FOR THE FUTURE REMOVAL OF THE CONDIT DAM. WOULD YOU PLEASE DISCUSS THIS

ISSUE?

A. PacifiCorp has entered into a settlement agreement with the U.S. Department of Interior and several environmental groups. The agreement requires the Company to remove the Condit hydro electric dam commencing October, in the year 2006. The agreement may be withdrawn or terminated under the following conditions:

SECTION 5 MODIFICATION OR WITHDRAWAL AND TERMINATION

5.1 Withdrawal. A Party may withdraw from this Agreement in accordance with this Section 5.1 after complying with Section 5.2.

5.1.1 Amended License Not Timely Issued by the Commission. Any Party may withdraw from this Agreement if the Amended License is not issued by the Commission within three (3) years of the Effective Date of this Agreement.

5.1.2 Amended License Inconsistent With This Agreement. Any Party may withdraw from this Agreement if the Amended License issued by the Commission contains terms or conditions materially inconsistent with those set forth in the Agreement. In the event the Commission modifies, fails to require compliance with, or changes in the Amended License a term or condition that the Parties have agreed to in this Agreement, and this Agreement is not terminated in accordance with Section 5.3, the term or condition as set forth in this Agreement shall remain a binding covenant among the non-withdrawing Parties, enforceable in accordance with the law of contracts (except to the extent the Amended License prohibits or precludes the performance of that term or condition). In the event a notice of intent to withdraw is filed, the provisions of Section 5.2 shall come into effect unless the Amended License is revised to conform to the Agreement. All Parties shall request the Commission to stay the rehearing proceeding pending the completion of the activities specified in Section 5.2.

5.1.3 Permit Terms and Conditions Inconsistent with Agreement. If any Permit includes a term or condition which is materially inconsistent with the terms and conditions of this Agreement, any Party affected by such inconsistency may withdraw from this Agreement.

5.1.4 Inability to Obtain Required Permit. PacifiCorp may withdraw from this Agreement if it is not able to obtain a Permit in final form on terms and conditions consistent with this Agreement which is necessary to implement the Removal Plan or the Amended License after exercising all good faith efforts and fully exhausting all avenues of appeal.

5.1.5 Inability to Obtain Required Easement, Right-of-Way, Other Interest in Property, or Third-Party Consent. PacifiCorp may withdraw from this Agreement if it is not able to obtain an easement, right-of-way, other interest in or to property, or the consent of any person or entity which is required by law to implement the Removal Plan or the Amended License after exercising all good faith efforts and fully exhausting all applicable avenues of appeal, if any.

5.1.6 Inability to Obtain Contracts to Perform Removal and Implement Mitigation. PacifiCorp may withdraw from this Agreement if it is not able after exercising all good faith efforts to obtain a contract with a qualified, responsive bidder to perform Project removal and to implement mitigation required by this Agreement or any Permit in accordance with the limitations on Project Removal Costs and other terms and conditions of this Agreement.

5.1.7 Injunction Prohibiting Project Removal or Implementation of Any Permit or Mitigation. PacifiCorp may withdraw from this Agreement if an injunction or similar order in any Proceeding prohibits PacifiCorp from implementing Project removal or any Permit or mitigation required by this Agreement after exercising all good faith efforts and fully exhausting all applicable avenues of appeal to have such injunction or other similar order vacated or modified to conform with this Agreement.

5.1.8 Inability to Confirm In Lieu Site Enhancement Agreement. PacifiCorp may withdraw from this Agreement if it is unable after due diligence to confirm an In Lieu Site Enhancement Agreement with the Tribes within forty-five (45) days of the Effective Date of this Agreement.

5.1.9 Inability to Obtain Release of Claims from the United States in Its Capacity as Trustee. PacifiCorp may withdraw from this Agreement if the United States in its capacity as trustee on behalf of Indian tribes fails to provide, within forty-five (45) days of the Effective Date of this Agreement, a release and discharge to PacifiCorp's satisfaction of any and all claims for legal or equitable relief, causes of action, damages, or liabilities caused by, associated with, or in any way attributable to (a) PacifiCorp's ownership, use, operation or maintenance of the Project or (b) the removal of the Project with respect to Tribal interests in the fishery resources or fishery habitat of the White Salmon River and the Columbia River and in lieu sites, except for PacifiCorp's obligations under this Agreement.

If the agreement does go forward, PacifiCorp is limited in its expenditure for removal of the dam to $13,650,000. Additionally, the agreement calls for $2,000,000 to be incurred by PacifiCorp in support of the construction effort.

Q. ARE THERE ANY OTHER COSTS WHICH THE AGREEMENT REQUIRES PACIFICORP TO MAKE SHOULD IT NOT BE TERMINATED?

A. Yes. The agreement calls for PacifiCorp to make, in effect, charitable contributions of $1,000,000 to the "Nation" for the enhancement, supplementation and conservation of fishery resources in the White Salmon basin. Also, PacifiCorp shall contribute $500,000 for the enhancement, maintenance or other

use of the Underwood In Lieu Site located near the confluence of the White Salmon and Columbia Rivers. The agreement, which was signed September 22, 1999, requires these costs to be stated in terms of 1999 dollars. That is: the actual payment made in some future period will be adjusted so that it is stated in 1999 dollars.

Q. DOES THE AGREEMENT ALLOW FOR THE DECREASE IN THE AMOUNT OF PAYMENT AND BY PACIFICORP?

A. Yes, it does. Section 4.4 states:

> The parties agree to consider commencement of removal in October 2005 or earlier if the Interveners can identify additional funds which significantly reduce PacifiCorp's financial contribution to Project Removal Cost, provided that no change shall be made in the Project removal schedule described in this section 4.4 except in writing approved by all parties to this agreement.

Q. THIS AGREEMENT WAS SIGNED OUTSIDE OF THE TEST YEAR, IS THAT CORRECT?

A. Yes, the agreement was signed, in its entirety, September 22, 1999.

Q. DO YOU BELIEVE THAT THE DEPRECIATION EXPENSE BEING RECORDED BY PACIFICORP FOR THE DAM ABANDONMENT COST SHOULD BE RECOVERED FROM RATEPAYERS CURRENTLY?

A. No, I do not.

Q. WOULD YOU PLEASE STATE YOUR REASONS?

A. First, the incurrence of this expense, if it occurs at all, will be well outside the test year. If the agreement is not voided by one of the termination conditions, the construction costs for the removal of the dam will occur October 1, 2006 and is limited to $13,650,000 in 1999 dollars. Additional internal

costs of up to $2,000,000 may be incurred by PacifiCorp. These costs are really in the nature of an abandonment loss. PacifiCorp entered into an agreement to remove the dam for economic and environmental reasons. This, in effect, requires them to abandon this dam. Removal costs, which are accrued through depreciation rates in the normal course of business, are accrued over the life of the plant because it is clear that the facility will be removed at the end of its useful life. Dams are not in the category of facilities which are subject to the accrual of removal costs because they generally are never removed and operate without a term and a life. In fact, this particular dam will be in its 93rd year of operation when it is removed from service.

Secondly, there is no reason to charge ratepayers currently for a cost that will be incurred in the year 2006 and beyond. Current ratepayers are no more responsible for the abandonment loss than those ratepayers who will be receiving service from PacifiCorp in the year 2006.

Q. IS THE ABANDONMENT LOSS WHICH THE COMPANY IS TRYING TO RECOVER AS DEPRECIATION RELATED TO THE ENERGY BEING GENERATED BY THE PLANT CURRENTLY AND THROUGH THE YEAR 2006?

A. No. The abandonment loss is the result of an agreement entered into by the Company for economic and environmental reasons. It is no more related to the energy being generated from the dam in the year 1998 through 2006 then it is related to the energy generated from the plant in the year 1913.

Q. WHAT IS THE NEXT REASON THIS ACCRUAL SHOULD NOT BE CHARGED TO CURRENT RATEPAYERS?

A. The agreement was obviously signed outside the test year, on September 22, 1999, and does not meet the Commission's test year policy. In addition, there are numerous termination conditions to the

agreement which make the dam's removal uncertain. Inclusion of any removal costs in rates should not occur until the year 2006.

Q. IF THE COMMISSION DOES NOT RECOGNIZE THIS COST IN THE CURRENT RATE CASE, HOW WILL THE COMPANY RECOVER SUCH COSTS?

A. If the Company's rates and earnings are sufficient in the year 2006 to cover the actual expenditures, then the Company has obviously recovered the cost. If the Company files a rate case in the year 2006, or any subsequent year where these costs are incurred, they can recover the cost at that point in time. However, to include an accrual in the current costs for an expense to be incurred some six years hence when the earnings level of the Company will not be known violates both ratemaking principles and this Commission's policies which match costs to benefits for the period they are incurred.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. I am reversing the Company's depreciation expense for this abandonment loss. In addition, the rate base should be increased for the amount of depreciation expense which the Company has recorded in 1997 and 1998. These recommendations are presented on Exhibit 1.7.

Business Systems Integration Project (BSIP)/Systems Application Product (SAP)

Q. PACIFICORP HAS REQUESTED THAT APPROXIMATELY $80 MILLION OF SAP COSTS BE INCLUDED IN RATE BASE AND THAT DEPRECIATION AND AMORTIZATION EXPENSE ASSOCIATED WITH THIS COST BE ALLOCATED AND INCLUDED IN UTAH RATES. WOULD YOU DISCUSS YOUR REVIEW OF THESE COSTS AND THE BSIP/SAP PROJECTS AND OTHER RELATED COSTS?

A. Yes. The BSIP/SAP project was initiated by the former Chairman and Chief Executive Officer of PacifiCorp, Mr. Buckman. Studies were conducted throughout 1996 and into 1997 to examine the Company's current processes and accounting applications. This visioning and targeting project was designed to understand how the Company operated, how its management functioned, and what tools, that is, programs and documentation flow, management used to run the Company. This portion of the study was known as determining the AS-IS portion of the study. In other words, the Company spent a great amount of effort, time and money determining just what they were doing. This study was then coupled with a companion study, which sought to determine the best or most efficient way to accomplish the same paths for information flow and computer programs. This second study was the TO-BE study. These studies, accomplished under Mr. Buckman's prior management, envisioned a global company. That is, PacifiCorp would not only be a provider of retail and wholesale electric service, but it would also be a global marketer of power and natural gas. The Company and Mr. Buckman envisioned operations in England, the Philippines and, of course, Australia, where they currently own Powercor Australia Ltd. and at one time had an interest in the Hazelwood generating plant. Thus, the BSIP project as envisioned was of PacifiCorp as a global entity, and the tools envisioned were tools which would allow PacifiCorp to manage a global entity and its retail business in the United States from Portland, Oregon. The reports generated from this study were dated October 31, 1997.

Q. IN YOUR OPINION, DID THESE STUDIES AND ANALYSES DELIVER ANY PRODUCTIVITY GAINS TO THE COMPANY IN 1997 AND BEYOND?

A. These were preliminary studies designed to determine whether the process of integrating the Company's business systems and using the SAP tool to accomplish that integration would be feasible. Thus, it is not likely that any productivity gains were achieved by the BSIP process in itself without the

implementation and full functioning of the SAP program.

Q. WHAT WAS THE NEXT STEP IN THE PROCESS?

A. Mr. Buckman authorized the BSIP to go forward through the implementation of the studies through the SAP programs.

Q. WHAT DOES THE PROCESS TO CONVERT THE BSIP STUDIES INTO SOMETHING WHICH MIGHT PRODUCE PRODUCTIVITY GAINS ENTAIL?

A. As stated by Vice-President Don Bloodworth in the February 2, 1998, Network employee newsletter:

> The real focus of BSIP is changing and standardizing the company's business processes and linking our core business functions together. Because we are using a technology tool, SAP, to facilitate this project, it is very easy to say that BSIP is just another systems project. It's much more than that. In fact, the real cost and challenge for BSIP is in the configuring of our processes so that the SAP software is used the way it was intended. So the two are not mutually exclusive. There is a large piece of information technology embodied in this project. But the real focus and benefits are in business processes.
>
> Network: How will SAP support business change?
>
> Bloodworth: What this software tool enables, and really demands, is that we examine entire processes and configure them in accordance with best practices to capture the opportunities for efficiencies.
>
> One of the real beauties of this technology is its integration of information and its accessibility across functions. From operational work management all the way through to financials, every time information is entered it is available all the way to the end of the process chain.

Thus, in order for the BSIP to be useful, the Company's business systems had to be configured to use the SAP software programs.

Q. WHEN DID THIS OCCUR?

A. The Company (through the BSIP team, consultants from Deloitte and Touche and SAP America, Inc.) configured the Company's systems for the adaptation of SAP programs throughout 1998.

A. Invoices from Deloitte and Touche and the Company's newsletters indicate that 1998 did not see the implementation of SAP. Rather 1998 was, in fact, a period when the Company's processes were configured for adoption to the SAP programs. Invoices from Deloitte and Touche Consulting that we examined stated the consulting fees were "...in connection with the configuration phase of the BSIP SAP implementation project." In addition, the Company's newsletters show a clear indication that SAP was not up and running in 1998. The May 25, 1998 Company newsletter, Network, states as follows:

> SAP R/3 software will replace most finance, work management, materials management and human relations computer systems. Implementation will be completed company-wide by the end of 1999, and training begins in some areas this summer.

Thus, the Company never envisioned SAP being up and running in 1998, but planned on its implementation through 1999.

Q. EARLIER IN YOUR TESTIMONY, YOU INDICATED THAT A PILOT PROGRAM WAS IMPLEMENTED AT THE NAUGHTON PLANT ON SEPTEMBER 1, 1998. WHAT INDICATIONS WERE THERE THAT THIS WAS A PILOT PROGRAM AND A LIMITED RELEASE?

A. A Company report indicated that the pilot implementation release phase took place in September 1998. In addition, the PacifiCorp Today newsletter, dated January 15, 1999, stated, in part, that "About 275 users at Naughton and PacifiCorp Group Holding (PGH) began using a limited release of SAP in September, then expanded to the current release in December."

Q. EVEN THOUGH SAP WAS IMPLEMENTED ONLY ON A LIMITED BASIS IN SEPTEMBER OF 1998, WOULD THAT PRODUCE PRODUCTIVITY GAINS AT LEAST AT THAT PLANT?

A. Not hardly. As stated by Mr. Bloodworth, in his February 2, 1998 interview by the Network newsletter:

> One of the real beauties of this technology is its integration of information and its accessibility across functions. From operational work management all the way through financials, every time information is entered it is available all the way to the end of the process chain.

Thus, for any productivity to be experienced from the SAP system, all the employees have to be on the system and all functions properly integrated. In addition, the productivity gains, if any, will not be experienced without significant re-training of employees and changing the corporate culture to one of a SAP enterprise culture. As Mr. Bloodworth also stated in the February 2 interview, "If the Company's redesigned process and systems are rejected by the organization, this will lead to failure."

Q. BEFORE YOU GO FURTHER WITH DISCUSSING THE NEED TO RETRAIN AND CHANGE CORPORATE CULTURE, PLEASE LAY OUT FOR THE COMMISSION THE ACTUAL NUMBER OF EMPLOYEES IN THE COMPANY AND THE AVAILABILITY OF SAP TO THOSE EMPLOYEES, AS INDICATED IN THE COMPANY'S NEWSLETTER.

A. The Company's FERC Form 1, as of December 31, 1998, indicates that the Company had, in total, 8,070 full and part-time employees in its electric operation. The Company's newsletters indicate that SAP was available for use by Company employees as follows:

Date	Release	No. of Employees
September 1, 1998	Release A	171
December 22, 1998	Release B1 the Naughton Plant Employees	0
January 11, 1999	Release B1 SAP/R3 Software to Power Supply and Corporate Employees	1,999
May 10, 1999	Release B2 SAP/R3 Software to Corporate, Transmission and Distribution Employees	2,170

Total Employees	4,340

An additional 2,000 employees were scheduled to have SAP available to them at the mining operations, but that roll-out has been delayed until after 1999. Thus, it appears that only approximately 54% of the employees at PacifiCorp had SAP available at the end of 1999. Virtually, no employee utilized the program throughout 1998.

Q. WHEN DID TRAINING ON SAP BEGIN?

A. Even with the implementation of these programs in 1999, a significant amount of training would be necessary for any employee to begin to utilize the programs. The Friday, January 22, 1999 PacifiCorp Today newsletter indicates that 660 training classes scheduled for 13 sites would assist those who started using SAP January 11, 1999. The April 6, 1999, newsletter indicated that those slated for the May 11 SAP roll-out would start training that week, with 46 classes scheduled for corporate, transmission and distribution employees, and with another 64 classes offered the week of April 12.

Even with the training, the Company's newsletters indicate a need for a change in the corporate culture and employee acceptance of these programs for them to be actually functional in providing possible productivity gains. The following quote from the Friday, October 8, 1999 newsletter emphasizes the need for employee involvement in making these programs productive.

The truth about SAP: part 1 of 2
New system offers vital challenges

Tell the truth. You hate changing computer software, ignored SAP as long as you could and now it's time to play catch-up. Training classes help, but you know it'll take more.

The first thing to understand is that there's more to the new system than just software. It's really about creating company-wide procedures that streamline the way we do business – something we haven't always been very good at.

SAP is simply a tool to help us keep track – minute-by-minute – of how we're doing. It should help do things more efficiently using less time and money, but that will require everyone's help.

To get there, six senior officers have been named "process owners," accountable for putting together teams that get down to the nitty-gritty as processes interact with strategy, resources, union agreements, Y2K implications and all the other details that make PacifiCorp tick.

The process owners are:

B. John Bohling - order management; logistics, materials and services, barcoding
C. Barry Cunningham - facilities maintenance
D. Bob Dalley - finance
E. Tim Meier - technology
F. Mike Pittman - human resources
G. Rich Walje - facilities and fleet management

But they can't know all the ins and outs about making SAP work. Which is why employees at every level need to lend a hand.

What are the big challenges of SAP?
PacifiCorp Tody asked: What are SAP's big challenges?

Walje: The biggest challenge is getting everyone up to speed on SAP fundamentals so we can begin to explore the system's capabilities. Once we know what we're doing, we can get organized information to managers for interpretation and continue developing better processes.

Meier: We need to encourage a willingness to think creatively and be ready to do things in different ways. Managers have a tendency to be complacent and that has to change.

Cunningham: People become comfortable over time. We need to convince our folks that this tool will be better than what we had before. And we need to accelerate that thinking any way we can.

Bohling: Everyone should look at their work and see how it relates to other, then tell us how to do it better - or even just go ahead and do it. Most meaningful process changes come from people actually involved in the day-to-day.

As late as October 1999, the Company was indicating that no productivity gains would be forthcoming from the SAP programs without complete training and an essential change in corporate culture.

Q. ARE THERE CONCERNS ABOUT SAP AND ITS CAPABILITIES IN USE BY THE MANAGEMENT OF THE COMPANY?

A. Yes, there are. **Begin Confidential**

End Confidential

Q. WHAT IS YOUR RECOMMENDATION?

A. My recommendation is that the Commission not allow any cost related to BSIP/SAP at this time. I also recommend that a full audit of such costs and benefits be performed by the Division of Public Utilities

(Division) or a consultant hired through the Division to assure that: (1) all costs incurred were prudent and are used and useful to ratepayers; (2) the costs incurred will at least equal the benefits in the year the Commission allows them for ratemaking purposes; and (3) there has been a proper allocation of costs between regulated and non-regulated businesses of the Company.

Q. WHAT DOES THE ADJUSTMENT YOU ARE RECOMMENDING ACCOMPLISH?

A. The adjustment I am recommending reverses and removes from rate base the $80 million investment which the Company has added as associated with the BSIP/SAP system. I have also removed the amortization associated with this software. These recommendations are shown on Exhibit 1.8.

Q. WHAT ADJUSTMENTS HAVE YOU RECOMMENDED THAT ARE RELATED TO THE BSIP/SAP PROJECTS?

A. The following adjustments are related to the BSIP/SAP projects: software obsolescence costs; mainframe write-off; and re-engineering costs. Each of these adjustments were discussed previously in my testimony.

Imputed Revenue For Western Area Power Administration

Q. PLEASE EXPLAIN THE ADJUSTMENT YOU ARE RECOMMENDING FOR THE WESTERN AREA POWER ADMINISTRATION (WAPA) LONG TERM CONTRACT.

A. The Company provides wheeling services to the Western Area Power Administration (WAPA) under a long-term contract. The long-term contract does not reflect cost of service rates as determined by the FERC. They are, in fact, significantly below what those rates would generate if WAPA were to receive service under such rates. WAPA revenues are credited to the retail cost-of-service and are not allocated to a separate wholesale jurisdiction. Since there is no wholesale allocation of PacifiCorp's

costs, the revenue deficiency is subsidized by Utah ratepayers. In order to correct for that deficiency, the difference between rates that WAPA would have paid under authorized FERC rates and the revenue actually collected from WAPA is imputed into the current rate filing. That adjustment which is shown on Exhibit 1.14 is $3,681,803 on a total Company basis and $1,284,143 on a Utah jurisdictional basis.

Q. HAS THE COMPANY PERFORMED A COST BENEFIT ANALYSIS THAT JUSTIFIES THE LOWER THAN COST OF SERVICE RATE?

A. No, it has not. PacifiCorp claims that the benefits of the WAPA contract somehow flows to ratepayers through the allocation process. If that were the case, the Company should be able to demonstrate that through a cost/benefit analysis. Since PacifiCorp has not done so, it would not be appropriate for Utah ratepayers to subsidize the WAPA contract.

Organization Costs

Q. PLEASE DISCUSS PACIFICORP'S ADJUSTMENT TO ORGANIZATION COSTS.

A. On page 8.10 of its filing, PacifiCorp made an adjustment to accelerate the amortization of organization costs for the Utah Power & Light Company and Pacific Power & Light Company merger. Absent PacifiCorp's acceleration, the organization costs would have been fully amortized in the year 2000.

Q. WHY DID THE COMPANY ACCELERATE THE AMORTIZATION IN THIS CASE?

A. PacifiCorp claims that the amortization was changed "to match the Commission ordered phase-in period to rolled-in allocation and elimination of merger cost related issues." The Company's proposed adjustment would result in the merger organization costs being fully amortized during the year 2000,

which is six years ahead of schedule. According to PacifiCorp's response to CCS 4.71, the Company is proposing a three-year amortization of the remaining costs "in accordance with Docket No. 97-035-04 where the Committee proposed and the Commission concurred that by January 1, 2001, no further merger fairness adjustments shall be made."

Q. IS THE COMPANY'S ADJUSTMENT APPROPRIATE?

A. No, it is not. The decision in Docket No. 97-035-04 did not address the organization costs on the Company's books associated with the merger. The decision addressed the merger fairness adjustment, not the organizational costs resulting from the merger. On Exhibit 1.9 I reversed the Company's adjustment. The amortization of the organization costs should not be accelerated.

Y2K Adjustment

Q. SHOULD THE TEST YEAR COSTS PERTAINING TO Y2K COMPLIANCE BE ADJUSTED?

A. Yes. The Company incurred, on a total Company basis, $10,316,162 of Y2K expense in 1998. This compares to approximately $2.7 million included in rates in 1997. Y2K expenses, of course, will no longer be incurred in the year 2000 and beyond. Therefore, it would be appropriate to normalize the expenses and recover them over a longer period of time.

Q. WHAT AMORTIZATION PERIOD ARE YOU RECOMMENDING?

A. I am recommending a five-year amortization of the 1998 expenses incurred. The Utah allocation of Y2K expenses in 1998 was approximately $3.6 million. Amortizing this allocated expense over a five-year period would reduce the test year amount by $2,899,479, as shown on Exhibit 1.10. That is the adjustment I am recommending.

Customer Service System Disallowance

Q. IN DOCKET NO. 97-035-01, A STIPULATION WAS ENTERED INTO REGARDING THE CUSTOMERS SERVICE SYSTEM, WOULD YOU PLEASE DISCUSS THAT STIPULATION?

A. In the last Docket, the Company agreed to the partial disallowance of the Customer Service System. That disallowance entailed the removal of one-third of PacifiCorp's investment in the Customer Service System from plant accounts. In addition, one-third of the maintenance costs associated with the operation of the Customer Service System was removed from consideration in rates in the stipulated agreement.

Q. HAS THE COMPANY FOLLOWED THE STIPULATION IN THE CURRENT CASE?

A. No, not entirely. PacifiCorp removed one-third of the investment in the Customer Service System. However, it did not remove one-third of the maintenance expense associated with the system.

Q. WHY HAS THE COMPANY NOT FOLLOWED THE STIPULATION?

A. The Company claims there is no need to remove maintenance expense because it was associated with regulated business activity.

Q. IN THE LAST DOCKET, DID THE COMPANY CLAIM THAT THE ENTIRE CUSTOMER SERVICE SYSTEM AND THE RELATED MAINTENANCE COST WAS ASSOCIATED WITH REGULATED BUSINESS ACTIVITIES?

A. Yes. PacifiCorp made the same claim in that case. However, the stipulation removed one-third of both the investment in the CSS and the related maintenance expenses.

Q. SHOULD THE STIPULATION BE FOLLOWED IN THIS CASE?

A. Yes, it should. There has been no showing, on the part of the Company that the maintenance costs incurred in the 1998 test year is any different then those incurred in the last case. In fact, the operation of the Customer Service System has resulted in customers receiving inaccurate bills, and the Company did not follow its normal collection process for fear of turning-off customer services when the customer had actually paid their bill. This fact alone would be sufficient to remove some part of the maintenance cost for the Customer Service System; however, since there is an existing stipulation in which one-third of the maintenance cost was removed, it would be proper for the Commission to follow that stipulation and remove one-third of the maintenance costs associated with the Customer Service System in this case.

Q. HAVE YOU PROPOSED SUCH AN ADJUSTMENT?

A. Yes, I have. It is shown on Exhibit 1.11. It removes one-third of the total Company maintenance expense for the Customer Service System and allocates a portion of that removal to Utah ratepayers.

Unbilled Revenue

Q. PLEASE DISCUSS THE UNBILLED REVENUE CORRECTION REFLECTED ON PAGE 3 OF EXHIBIT 1.1.

A. There was an error in the Company's unbilled revenue calculation during the test year. According to PacifiCorp's response to CCS 24.44, "the impact of the error was to understate Utah's revenues by $6,109,000." I increased test year revenues by the $6,109,000 on Exhibit 1.1, page 3, to correct the error.

Line Extension Revenues

Q. THE COMPANY HAS REQUESTED A CHANGE IN LINE EXTENSION POLICY WHICH

COMMITTEE WITNESS DR. LINEBARGER HAS ANALYZED AND AGREED WITH. WOULD YOU PLEASE STATE HOW THE CHANGE SHOULD BE TREATED FOR RATEMAKING PURPOSES?

A. Since this will be a change in rates, the average line extension revenue to be collected should be pro formed into the 1998 test year as a rate base reduction. This is necessary in order to reflect the fact that the Company will have, on average, less investment in its distribution plant because of this change in rates. To not do so would establish rates at a higher level than appropriate and allow the Company to earn a rate of return greater than that authorized by the Commission in this docket.

Q. WHAT ADJUSTMENT IS NECESSARY TO REFLECT YOUR RECOMMENDATION?

A. In response to DPU 3.12b, PacifiCorp provided the estimated annual increase in residential contributions resulting from the proposed change in residential line extension allowance. DPU 3.12c asked the Company to provide similar information for the commercial, industrial and other customers. The Company's response was that the information is not available because the proposed allowance for these groups is one times the estimated annual revenue. Exhibit 1.15 presents the adjustment to reflect the impact of the reduction in the residential extension allowance. The adjustment reduces rate base by $6,435,168 on a Utah basis.

Q. WHAT ADJUSTMENT IS NECESSARY TO REFLECT THE IMPACT OF THE CHANGE IN COMMERCIAL, INDUSTRIAL AND OTHER LINE EXTENSION ALLOWANCES?

A. The Company has not provided the information that would be necessary to make such a determination. As previously mentioned, the Company stated that the proposed allowance is one times the estimated annual revenue. The Company could make an estimated calculation based on the annualized revenues received from the industrial, commercial and other customers that were new during the test year. The Commission should require PacifiCorp to provide the estimated annual

increase in contributions to be received from these types of customers as a result of its proposed change in line extension allowance. If the Company does not provide such information, then its proposed change in line extension allowance for these customers should be denied. It would not be appropriate to allow the change in rates without reflecting the associated impact on revenue requirement. Currently, the Company's policy for non-residential customers allows the greater of three times estimated annual revenue, or transformer, meter, service plus up to 300 feet of distribution facilities. The Company is proposing to base the non-residential line extension policies on one times estimated annual revenues and to disallow a line extension allowance for customers receiving service at transmission voltage (Schedule 9). This proposed change could have a significant impact on the amount of contributions received from non-residential customers.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.