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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of PACIFICORP for Approval of its Proposed Electric Service Schedules and Electric Service Regulations	DOCKET NO. 04-035-42

PREFILED DIRECT TESTIMONY OF RICHARD M. ANDERSON

[REVENUE REQUIREMENT]

The UAE Intervention Group hereby submits the Prefiled Direct Testimony of Richard M. Anderson on revenue requirement issues.

DATED this 3rd day of December, 2004.

Gary A. Dodge,
Attorney for UAE Intervention Group

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was sent this 3rd day of December, 2004, to the mail or email addresses listed below:

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PREFILED DIRECT TESTIMONY

Of

RICHARD M. ANDERSON

[Revenue Requirement]

On behalf of UAE Intervention Group

In the Matter of the Application of PACIFICORP for Approval of its Proposed Electric Service Schedules and Electric Service Regulations

Docket No. 04-035-42

December 3, 2004

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Richard M. Anderson. My business address is 39 West Market Street, Suite 200, Salt Lake City, Utah 84104.

Q. FOR WHOM DO YOU WORK AND IN WHAT CAPACITY?

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a professional consulting firm offering litigation support, asset development services, and risk management services in the natural gas and electricity market areas. Our client base is nationwide, including Fortune 500 entities and multiple public institutions.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I received a Bachelor of Business Administration from the University of Texas at Austin and a Ph.D. in Economics from the University of Utah.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. I have worked in the energy field for approximately 23 years. My work has centered on economic assessments of a variety of issues and policy development. Prior to joining Energy Strategies in 1994, I spent nine years as Director of the State of Utah's Energy Division where, as an appointee of the Governor of Utah, I was charged with supporting the development of state energy policy on both energy resource development and energy conservation.

Since joining Energy Strategies, I have concentrated primarily on electricity issues. In that regard, I have performed work in the areas of litigation support, market assessment and market strategy, and electricity procurement/contract negotiations. I have provided expert testimony before the Public Utility Commission/Public Regulatory Commission/Public Service Commission(s) in Idaho, New Mexico, Nevada, Oregon, Texas, Utah, and Wyoming. Attached as Exhibit UAE 1.1 (RMA-1) is a summation of my professional experience.

Q. ON WHOSE BEHALF ARE YOU FILING TESTIMONY IN THIS PROCEEDING?

A. I am filing testimony on behalf of the Utah Association of Energy Users' Intervention Group (UAE).

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will address three primary areas. First, I will address the prudence of PacifiCorp's (the Company) expenditures for the West Valley and Currant Creek plants and provide a comparative analysis of the cost incurred for those two plants measured against a different available generation option. The analysis will reflect significant savings the Company could have experienced had it made prudent decisions as to when and what generation resources would be developed. I will explain how the Company should have recognized and reacted to substantial load growth in the Utah service area sooner, but instead chose to delay action to protect shareholders' interests. A conservative estimate of available savings from a prudent course of action will be the basis for a suggested cost disallowance. The calculation of the proposed disallowance will be presented by UAE witness Neal Townsend.

My second area of inquiry addresses concerns over the forecasted test year used by the Company. This is the first time in many years that a forecasted test year has been used by PacifiCorp and the first in history, to my knowledge, in which a Utah utility has proposed to set rates based on projections 20 months into the future. As a result, it is very important that all of the Company's forecasts be carefully reviewed for reasonableness. Budget constraints do not permit us to conduct a detailed analysis of all of the forecasted values. However, our review identified several areas in which the Company's projected costs and forecasts appear to be inappropriate or inadequately supported. For example, the Company has not supported a need for its projected increase in the percentage of equity in its capital structure. I recommend the use of a hypothetical capital structure as used in prior cases. I also address concerns in other forecasted areas, such as labor count and labor costs. I recommend that projected changes be accepted only if properly supported.

My third area of focus is the concern that ScottishPower and its unregulated affiliates may take advantage of the regulated utility to recover inappropriate expenses and to extract unacknowledged returns. A careful analysis is necessary in several areas, including incentive compensation, management fees, and income taxes. With respect to taxes, I propose a disallowance of projected income taxes unless and until PacifiCorp demonstrates a reasonable likelihood that it will pay income taxes on test year revenues.

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Yes, Exhibits UAE 1.1 – 1.10 (RMA-1 through RMA-10**)** provide supporting documentation and empirical representation of the analyses and suggested disallowances.

Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR CONCLUSIONS.

A. It is very apparent that the planning effort undertaken by the Company in the late 1990s up through the early 2000s did not reflect the actual economic behavior of the Utah economy. The Company has and continues to argue that, due to unprecedented and unanticipated load growth in Utah, the Company had to react on an emergency basis to acquire new generation resources. The Company made such arguments in support of the building of the Gadsby peakers, the leasing of the West Valley units and the building of the Currant Creek generation unit. Yet, the Company's own data shows that load growth in Utah since the mid-1990s was increasing at a rapid rate and reflects sustained peak load growth throughout the last half of the decade and into the early years of the current decade. The Company's planning efforts, as demonstrated in its RAMPP reports, failed to acknowledge this growth and, instead, continued to suggest that any peak load growth (which was not viewed as problematic) would be met with increased short-term purchases. In fact, as late as the RAMPP-5 study filed in 1997, the Company was projecting no need to acquire new resources until 2012.

The Company's planning efforts during this time period were driven by considerations other than the need to meet future load. Instead, convinced that the regional market was on the brink of deregulation, the Company's attention was focused on three primary issues: how best to position itself in the new market arena; how to ensure recovery of its perceived stranded cost; and how to ensure full cost recovery in light of differences in interstate allocation methodologies. All of these goals stem from a desire to protect or enhance stockholder value. While the Company has a fiduciary responsibility to its stockholders, it simultaneously has an equally important responsibility to ratepayers to ensure the most cost effective and reliable services are developed. During this crucial period of planning, the Company's focus was not balanced. The result is that ratepayers are now being asked to embrace investments that were, by lack of poor planning, imprudent and not cost effective.

With regard to the forecasted values used by the Company, the Company has shown no support for its projected capital structure. Lacking sound justification, there is no reason for this Commission to adopt a capital structure different from that used in the past.

Finally, with regard to the issue of income taxes, the evidence is now available regarding the income tax liability for PacifiCorp revenue as a result of the ScottishPower merger. Unless and until the Company makes a reasonable showing that income taxes will be paid with respect to PacifiCorp revenue, projected expenses for income taxes should be disallowed.

III. RESOURCE PLANNING AND PROCUREMENT

Q. HAVE YOU EVALUATED THE COMPANY'S RESOURCE PROCUREMENT PROCESS?

A. Yes. I have focused principally on the Company's proposed cost recovery for the West Valley generation plant lease and the Currant Creek generation units. New generating resource capital additions are identified by the Company as one of the key drivers of increased costs in the future test year. (Weston Direct, 8:12-16)

Q. WHY IS THIS DRAMATIC INCREASE IN GENERATION RESOURCE CAPITAL APPEARING IN THE FUTURE TEST YEAR UTILIZED IN THIS FILING?

A. The addition of generation resource capital is in response to what the Company argues to be substantial and unprecedented growth in load in the Utah service area. Previous discussions of the need for some of these resources have taken place before this Commission in other dockets.

Q. IF THE NEED FOR THESE RESOURCES HAS ALREADY BEEN REVIEWED BY THIS COMMISSION, WHY DO YOU BELIEVE THEY SHOULD BE SUBJECT TO INQUIRY IN THIS FILING?

A. The Commission determined that the Gadsby and Currant Creek resources were necessary to meet increasing load on the PacifiCorp system. The question of whether new generation was required has thus been answered. I do not seek to reexamine the issue of whether new resources were needed to meet projected load growth.

On the other hand, there remains a central and critical question that has not been addressed in previous Commission orders regarding the development of these resources. This question centers on the Company's prudence in its load and resource projections and the timing with which the Company pursued new resources. The Company's testimony in seeking approval for the Gadsby and Currant Creek plants argued that the resources in question were required immediately to meet surging load growth in Utah. Indeed, immediacy of the need was the central theme that governed the Company's requests.

One is left to question how and why this immediacy materialized and whether the Company should reasonably have acted earlier and in a less costly manner to meet its growing load obligation. It is this question I investigate below.

Q. DID THE COMPANY FORESEE ITS GROWING NEED FOR NEW RESOURCES IN ITS RAMPP AND IRP FILINGS?

A. Surprisingly, no, at least not until its 2003 IRP. The Company first announced that it faced an immediate and substantial deficit in meeting eastern summer peaks in its 2003 IRP, which was filed in January of 2003. The 2003 IRP Update filed in October 2003 identified the 'Utah Bubble' as a transmission-constrained geographic area that was significantly short on capacity. Using the nomenclature adopted in the IRP update report, the 'Utah Bubble' was determined to place the Company in a Tier-1 position. The Company's projected net position in this area ranged from (-601) MWs in fiscal year 2005 (calendar year 2004) to (-1,939) MWs in FY 2010. (See page 14, 2003 PacifiCorp IRP Update). In light of apparent transmission constraints into the geographic area, the Company argued that it was forced to seek a variety of new resources (thermal, renewable, and DSM) in order to meet projected peak demand. In the 2003 IRP Update (page 20), the Company outlined an aggressive action plan aimed at addressing the capacity shortfall projected for the very next year, and beyond.

Q. HAS THE COMPANY SOUGHT THE RESOURCE ADDITIONS NOTED IN THE 2003 IRP ACTION PLAN?

A. Yes, Requests for Proposals (RFP) were issued for peaking, renewable, DSM and baseload resources. The 2003-A RFP led to the ultimate selection of the Currant Creek and the Lake Side generation projects. Additionally, the Company has sought renewable projects through its 2003-B RFP.

Q. WHAT DID THE COMPANY IDENTIFY AS THE PRIME DRIVERS NECESSITATING THE NEED FOR THE DEVELOPMENT OF THESE RESOURCES?

A. The Company noted in its 2003 IRP that the key drivers were load growth, load shape, asset retirement and contract expirations. (2003 IRP Executive Summary, p. 1) As noted above in reference to the 'Utah Bubble,' the gap between load and resources was determined to be particularly acute along the Wasatch Front where the growth rate of the heavy load hours was greater than the growth rate of the average load. (2003 IRP, p.35)

Q. WHAT COMPANY PROJECTIONS ARE AVAILABLE FOR LOAD GROWTH AND RESOURCE GAPS IN UTAH?

A. UAE asked the Company to produce all documents reflecting load and resource projections and resource timing considerations for 2000 and beyond. The Company refused to produce any such documents, other than those contained in the Currant Creek data room. Absent production of such documents, we are left only with public statements such as those contained in RAMPP and IRP documents and prefiled testimony.

In the 2003 IRP, for the PacifiCorp system as a whole, the Company projected (p.33) a resource gap ranging from 1,200 MWs (2004) to 4,000 MWs (2014). Specific to the 'Utah Bubble,' the resource gap was identified as ranging from approximately 600 MWs in 2004 to 1,900 MWs in 2009. (2003 IRP Update, Executive Summary, p. 14)

The Company made similar claims of a resource gap in Utah Docket No. 01-035-37, in which it sought an emergency Certificate of Convenience and Necessity for the peaking units at Gadsby. The Company's Application noted that "During the 1997 through 2000 period alone, PacifiCorp's peak load along the Wasatch Front grow from 2,864 megawatts to 3,515 megawatts, an increase of approximately 650 megawatts." Company witness Janet Morrison, in her Direct Testimony, describes the findings of an August, 2001 Load and Resource Balance Study undertaken by the Company. Ms. Morrison notes, "The Utah region has experienced significant load increases over the past 20 years, and continues to grow." (Morrison Direct, 2:21-22) She further states, "Based on the PacifiCorp Position Report dated 08-02-01, it was shown that a shortage of resources occurs each year in Utah during the July Super-Peak hours." (Morrison Direct, 3:5-6) The resource gap, according to Ms. Morrison, was expected to grow, "from 439 MWa in July 2002 to 1,262 MWa in July 2009." (Morrison Direct, 3:7-8)

Q. WAS THIS GROWTH IN PEAK DEMAND AN EVENT THAT OCCURED ONLY IN RECENT YEARS?

A. No. Growth in peak load has been constant, significant and increasing in Utah for more than a decade. I have attached as UAE Exhibit 1.2_(RMA-2) a copy of the Utah Foundation January 2004 report entitled, *"Peak Load Growth Along the Wasatch Front: What's Driving Electricity Demand in Utah?"* According to the report, both peak electricity demand and average load demand have been growing constantly throughout the 1990s, with the gap between peak and average load increasing by approximately 200 MWs since 1991. (See p. 1 and Figure 1, p. 2) What is even more astonishing is that residential peak demand has grown at a compound annual rate of 7.4% since 1996 and the commercial sector's peak demand grew at 5.2% annually during the same time frame. (See p. 1) It should be noted that the Utah Foundation report is based entirely on PacifiCorp data.

Q. IS THIS LOAD GROWTH CONSISTENT WITH GENERAL ECONOMIC GROWTH OF THE STATE OF UTAH DURING THIS TIME FRAME?

A. Yes, the state experienced substantial economic growth during this same time period, as confirmed by data contained in the *Economic Reports to the Governor*, reports developed under the guidance of the Governor's Office of Planning and Budget. These reports include a multi-sector breakdown of the state's economy and demographics. They are presented to the Governor annually and represent the best available data on the state's economic performance at that point in time.

I have attached seven exhibits highlighting key economic indicators of the state's performance during the 1990s. Exhibits UAE 1.3 (RMA-3) and UAE 1.4

(RMA-4) are representations of the state's population growth by decade since 1950 and by year for the 1990s, respectively. Exhibit UAE 1.5 (RMA-5) and UAE 1.6 (RMA-6) represent the annual change in per capita income and total personal income respectively during the same time period. UAE 1.7 (RMA-7) and UAE 1.8 (RMA-8) are graphical representations of the change in Utah's Gross State Product in nominal and in 1996 dollars, respectively. Finally, UAE 1.9 (RMA-9) shows Utah Non-Agricultural Payroll Employment annually beginning in 1990.

The Exhibits demonstrate a clear trend. Throughout the 1990s the Utah economy was growing at a very healthy rate. In fact, the annual percentage growth in the SGP was 6.9%. Per capita income increased at an annual rate of 4.6%, total personal income increased at an annual average rate of 6.9%, and state population increased annually at 2.5%. These major economic indicators paint a picture of a state whose economic health was strong, robust and growing.

Q. WHY DO YOU CHOOSE TO HIGHLIGHT THE ECONOMIC INDICATORS DISCUSSED ABOVE?

A. These factors are key elements in the Company's forecasting of long-term electricity sales. In the Company's 2003 IRP Report the linkage of economic and demographic data to electricity sales is acknowledged (p. 360). The report states, "Forecasts of state population are used as forecast drivers." (2003 IRP, p. 361) Additionally, the report goes on to state, "Total personal income is used as a measure of "economic vitality" which impacts energy utilization in the commercial sector." (p. 361) The report also states, "Real per capita income is used as a measure of "purchasing power" which impacts energy choice in the residential sector." (p. 361) It appears, therefore, that theses economic indicators are data upon which the Company would focus, and certainly should have focused, when analyzing the long-term forecast for electricity sales in Utah.

Q. DO THESE DATA SUPPORT THE FINDINGS IN THE UTAH FOUNDATION REPORT?

A. The economic data reported in the *Economic Reports to the Governor* clearly support the findings in the Utah Foundation report. As the Company stated in its own IRP report, there are key linkages between economic indicators and the sale of electricity. What the Governor Reports indicate is that the Utah economy was in an expansive state throughout the 1990s and was growing in terms of output, income and population. The Utah Foundation study, in turn, demonstrates that peak electricity demand was also growing, and at a more rapid rate than average load since about 1991. Additionally, the Foundation's conclusion that both residential (7.4% annually) and commercial (5.2% annually) peak demand had increased by a substantial growth rate since 1996 indicates that the economy's health was being mirrored in growing electricity sales. It should be noted, also, that the Foundation study (much like the Company's IRP Report) found a substantial causal link between the growth in income and the growth in electricity consumption (see p. 12).

Q. DID THE COMPANY'S PLANNING EFFORTS DURING THIS TIME PERIOD RECOGNIZE OR CAPTURE THIS SURGE IN UTAH ECONOMIC AND LOAD GROWTH?

A. No, at least insofar as such recognition is reflected in publicly available reports.[1] I have reviewed the Company's RAMPP/IRP reports filed with this Commission from RAMPP-4 (filed in 1995) through the 2003 IRP. Not until the 2003 report did the Company acknowledge an acute resource gap in its Eastern control area, primarily along the Wasatch Front. RAMPP-4 through RAMPP-6 each projected loads and resources that were generally in balance, noting that any short-term capacity shortages relating to summer peaks could be met with market purchases. RAMPP-4's (1995) major conclusion was that the Company did not need to make any decisions for future resource needs for at least three years (arguing that by postponing resource decisions, lower resource cost would be likely because of declining wholesale prices). (See RAMPP-4 Executive

[1] We asked the Company to provide non-public documents showing internal analyses and reports regarding load/resource balance projections and resource decisions from 1995 forward, but they have not been provided. As discussed below, publicly available planning documents suggest a disturbing lack of awareness of or responsiveness to constantly growing Utah loads and resource needs. Utah regulators criticized the Company for a "disconnect" between the public resource planning documents and the Company's internal decision-making process. The consequences of this "disconnect" were exacerbated by the fact that the RAMPP documents appear to have been designed largely to provide cover for the Company's unwillingness to commit to long-term resources in an effort to shield shareholders from risk, as discussed below. There was consistency between the RAMPP documents and the Company's actions in this one sense – RAMPP documents did not timely predict and the company did not timely respond to Utah's growing resource needs. Unfortunately, in neither case were the best interests of Utah ratepayers protected.

Summary, p. 2) RAMPP-5 (1997) took the decision not to build resources a significant step further. The RAMPP-5 study concluded that, for the base case that was analyzed, no new resources would be required until 2012. (See RAMPP-5, p. 145) Again, the Company stressed that any short-term capacity shortages (which would be peak load related) would be met through market purchases. Finally, in RAMPP-6 (2001), the Company noted that its load/resource ratio may be near balance and that the Company might, if high wholesale prices continue, accelerate development of its own resources.(See RAMPP-6, p. i) This conclusion, reached in June of 2001, follows a decade in which average and peak load in Utah had been steadily increasing, in line with economic growth.

Q. DID THE COMPANY ACTIVELY PURSUE RESOURCE DEVELOPMENT DURING THIS TIME OF ECONOMIC GROWTH?

A. No. The Company generally ceased pursuing new resources after it acquired power from the Hermiston plant in 1996. Prior to that the Company had acquired power from the Cholla Unit in Arizona and the Hayden unit in Colorado. Both of those acquisitions took place by 1994. As has been discussed before this Commission in prior rate cases, these acquisitions served primarily to position the Company as a major player in the wholesale market and were not specifically intended to meet increasing native load.

Q. DID THE COMPANY BELIEVE THAT ITS RESOURCE PORTFOLIO

WAS ADEQUATE TO MEET ITS REGULATORY OBLIGATIONS?

A. As noted above, as late as December 1997 the RAMPP-5 report stated that the Company believed it would not need to acquire or build new resources until 2012. (RAMPP-5, p. 145) This conclusion was also reiterated elsewhere. The Company's 1998 10-K filing, for example, notes, "Under critical or better water conditions in the Pacific Northwest, the Company believes that it has adequate reserve generation capacity for its requirements." (PacifiCorp 1998 10-K Report, p. 3) It reiterated its plan not to seek new resources until 2012. The Company stated, "The Company's base of existing resources, in combination with actions outlined in its integrated resource plan, are expected to be sufficient to meet load growth expectations through 2012." (PacifiCorp 1998 10-K Report, p.6)

Even as late as 1999, the Company was still predicting low to medium load growth and adequacy of resources. The Company noted,

> "For the periods 2001 to 2004, the average annual growth in retail kilowatt hour sales in the Company's franchise service territories is estimated to be about 1.4%. During this period, the Company may lose retail energy sales to other suppliers in connection with deregulation of the electric industry. As the electric industry evolves toward deregulation, the Company expects to have opportunities to sell any excess power in the wholesale markets. The Company's actual results will be determined by a variety of factors, including the outcome of deregulation in the electric industry, economic and demographic growth, and competition." (PacifiCorp 1999 10-K Report, p. 7)

It should also be noted that, despite caution as to the tightening of the load/resource balance discussed in RAMPP-6 (June 2001), the Company stated elsewhere that, "For the periods 2002 to 2005, the average annual growth in retail MWh sales in the Company's franchise service territory is estimated to be about 1.7%, …. Because of price increases throughout the region, the Company anticipates that demand growth will *slow or even reserves*." (Emphasis added) (PacifiCorp 2001 10-K Report, p. 8)

Q. IS THE LOAD GROWTH DATA PRESENTED IN THE RAMPP AND 10-K REPORTS CONSISTENT WITH THE ACTUAL LOAD VALUES REPORTED IN THE UTAH FOUNDATION STUDY?

A. No, they are clearly inconsistent. The actual PacifiCorp load data reported in the Utah Foundation study reflect an aggressive trend of load growth (in Utah) far in excess of what the Company consistently forecasted. In fact, in some cases the actual load growth was three to four times the growth rate the Company was publicly stating it anticipated.

Q. WHY DO YOU THINK THERE WAS SUCH A LARGE DISCREPANCY BETWEEN THE ACTUAL LOAD GROWTH AND WHAT THE COMPANY FORECASTED?

A. Part of the problem stems from a major shift in the Company's planning efforts beginning by the time RAMPP-5 was published and persisting until almost 2003. During the last half of the 1990 decade, the Company largely shifted its focus toward the wholesale market. In so doing, the Company greatly expanded the amount of wholesale transactions it undertook. This shift in wholesale strategy required a change in the Company's modeling of its IRP. New generation resources were not to be selected simply to serve the Company's expanding wholesale market commitments. To avoid such a modeling outcome, beginning in RAMPP-5 the Company adopted a balancing adjustment within the model which in effect isolated the wholesale commitments and forced the selection of new generation only for growth of native load. Given the forecasted load growth in RAMPP-5, the model indicated (as discussed above) no need for new generation resources until 2012.

The other problem area was the Company's focus on the potential for deregulation of the electric industry. Given that the forecast indicated adequate reserves, any new generation investment would serve to increase potential stranded investments in a deregulated environment.

Q. WHY WAS THIS FORECAST IN RAMPP-5 SO SERIOUSLY IN ERROR?

A. The forecast for new resource development in 2012 was predicated on several assumptions that failed to materialize. Additional, the Company disposed of resource capacity in the following years which also affected the load/resource balance.

Beginning with RAMPP-4 and continuing through RAMPP-5 and RAMPP-6, the Company asserted that the electric industry was on the brink of a major structural change due to deregulation. One of the key modeling assumptions the Company adopted in RAMPP-5 was the loss of 10% of its retail load to new competitors. (RAMPP-5, p. 2) This assumption continued into RAMPP-6 (June 2001) even though (at least with regard to Utah), the move toward deregulation had clearly been thwarted (primarily by the utility public lobbying effort) as early as 1999.

Other events also contributed to the failed forecast. The Company failed to complete a sale of its California service territory as projected and sold its ownership in the Centralia power plant (a loss of more than 600 MW).

Each of these events affected the load/resource balance of the Company. The effects of these events were compounded by the remarkably poor forecast of load growth the Company was projecting. (Again, one merely needs to contrast the 2% forecasted load growth for the years 1997-2000 as stated in the Company's 1996 10-K, p. 6 with the actual values shown in the Utah Foundation report.)

Q. WERE THE RAMPP-5 AND RAMPP-6 REPORTS ACKNOWLEDGED BY THE UTAH COMMISSION?

A. Neither report received acknowledgment from the Utah Commission. In its comments on RAMPP-6, the Commission stated,

> "we require the Company to file an updated Action Plan by June 1, 2002, which, at minimum, identifies the effects of updating out-of-date assumptions and inputs on the type, size, and timing of resource additions; …" (Utah Public Service Commission, Report and Order, Docket No. 98-2035-05, p. 6)

It should be noted that these comments by the Utah Commission were published February 28, 2002. Thus, as late as the first quarter of 2002, the Company still had not reconciled its own assumptions and forecast with the reality of the load growth in its service territory.

Q. DID EFFORTS TO PROTECT SHAREHOLDERS AFFECT THE COMPANY'S PLANNING AND RESOURCE PROCUREMENT EFFORTS?

A. The Company's planning processes and resource procurement decisions were significantly affected by the Company's desire to protect shareholder value in at least two areas. First, the Company was attempting to avoid the risk of stranded costs in the event of deregulation. Second, the Company was unwilling to commit to new long-term resources so long as it perceived a risk of less than full cost recovery due to inconsistent interstate allocations methods used by various states.

Q. PLEASE DISCUSS THE COMPANY'S FEAR OF DEREGULATION.

A. The Company was clearly concerned about potential deregulation within its market area, particularly in Oregon. Stranded cost (both of generation and regulatory assets) was a major subject matter often discussed by Company officials in forums regarding deregulation. The Company projected potential stranded costs ranging from $1.4 to $2.8 billion as of December 31, 1997. (PacifiCorp 1997 10-K Report, p. 29) The Company was, therefore, unlikely to undertake any new generation development since it would have been perceived as increasing potential stranded costs. Indeed, prefiled testimony filed by the Company in 2000 in support of its request for a Strategic Reorganization Plan in Docket 00-035-15 admitted that uncertainty over deregulation was creating "substantial risks and few incentives for either utilities or independent power producers to construct new generation." (Direct Testimony of Andrew N. MacRitchie, Matthew R. Wright and Donald N. Furman, December 2000, Docket 00-035-15, page 17, lines 11-14)

The Company clearly let its concerns over deregulation affect its retail resource planning. On the other hand, the Company actively sought to exploit opportunities in the wholesale market that were being created as a result of increasing competition. Its approach, as mentioned above, was to use an arbitrage model of wholesale purchases/sales. Thus, its desire to increase its presence in the competitive wholesale arena was undertaken without the development of any new generation resources.

The belief that the market would become more deregulated clearly worked against any new generation development being sought by the Company and to the disadvantage of Utah ratepayers.

Q. PLEASE EXPLAIN THE INTERJURISDICTIONAL COST ALLOCATION ISSUE.

A. As a result of the merger of Pacific Power and Utah Power in 1990, PacifiCorp served retail service territory in seven different states. Initially, most of the states agreed to use a common interstate cost allocation approach. Over the years, however, some states started utilizing different interstate allocation methods, resulting in the potential for less than full cost recovery by PacifiCorp. In 2000, PacifiCorp initiated formal efforts to resolve the interstate allocation shortfall by filing a “Strategic Reorganization Plan” or “SRP” in each of its states That effort ultimately was transformed into a “Multi State Process” or “MSP”, which culminated in an agreement among representatives from four of the states on a “Revised Protocol” for interstate allocations in 2004.

Throughout the multi-year SRP/MSP process, the Company repeatedly warned that it could not prudently build or acquire new long-term generation resources given the potential for an interstate allocation shortfall, and that the allocation issue forced it to rely upon short-term resources. For example, in testimony accompanying the Company’s SRP filing, the Company admitted that it had responded “not especially well” to the diversity of opinions from the various state regulators, leading to policies that “represent a common denominator of responses to regulation that does not appear to cause any of our regulators to conclude that we are being particularly responsive to their concerns,” and that “continued gridlock over interjurisdictional cost allocations” created “perverse incentives and disincentives.” (Direct Testimony of Andrew N. MacRitchie, Matthew R. Wright and Donald N. Furman, December 2000, Docket 00-035-15, 19: line 14-15 and 20; 21-22) The company warned that any future investment in new generation would require it to put billons of dollars of shareholder investment at risk. (21; 9-14)

Similarly, in its application to initiate an investigation of interjurisdictional issues in Utah in March 2002, the company acknowledged that divergent state policies on interstate allocations created circumstances that "are … not conducive to sound planning and business decisions by PacifiCorp on behalf of its customers and other stakeholders." (PacifiCorp's Application to Initiate Investigation of Inter-Jurisdictional Issues, March 5, 2002, Docket 02-035-04, page 4) In testimony filed in 2003 in support of its motion for ratification of interjurisdictional cost allocation protocol, PacifiCorp was slightly more blunt, explaining that a potential consequence of "continued lack of consensus among our states regarding responsibility for new resources" was that the company might satisfy its service obligations "in a manner that poses a higher level of risk for our customers and shareholders by relying upon shorter-term commitments that create exposure to price volatility and do not necessarily represent the least-cost approach to meeting our customers' expected load growth." (Direct Testimony of Andrew N. MacRitchie, September 2003, Docket 02-035-04, 13; 2-7) This admission that interstate allocation concerns could cause the company to acquire other than least-cost resources has now been confirmed as true.

Utah regulatory and ratepayer representatives regularly expressed concerns throughout the SRP/MSP process that the Company's refusal to invest in long-term resources was causing cost and reliability risks for Utah ratepayers. For example, the Division of Public Utilities confirmed: "Early in the MSP process the Division expressed its concern that in the absence of resolution of these issues, the Company has been and will likely remain reluctant to make adequate investment in new resources given its concerns about the risk of cost recovery." (Memorandum, Division of Public Utilities to Public Service Commission, March 5, 2004, Docket 02-035-04, page 1) Indeed, these concerns were openly acknowledged, and exploited, by PacifiCorp. For example, in a June 2002 paper provided by PacifiCorp in response to an order of the Wyoming Public Service Commission on MSP, the company acknowledged that "Utah is experiencing rapid load growth and increasing summer peak demands. It is concerned about the Company not adding additional generation resources because of uncertainty regarding inter-jurisdictional allocation issues." (PacifiCorp Response to WPSC Order on Further Participation by Wyoming in the PacifiCorp Multi-State Process, Docket 20000-EI-002-183, Wyoming PSC, page 3) In the same document, the Company identified potential risks of failing to reach consensus through the MSP process, including "a least common denominator approach to resource decisions [and] "risk averse" decisions by the Company that do not maximize efficiency." (at page 6) Again, these predictions have proven prophetic. The Company's "least common denominator" and "risk averse" decision-making approach to resources clearly failed to maximize efficiency and has led to higher cost resources.

In effect, the Company exploited the concerns of Utah regulators and customers over the lack of long-term resource development in order to obtain a

MSP consensus. Having obtained such a consensus, it now seeks to impose on Utah ratepayers the financial consequences of its unilateral delay in making long-term resource commitments.

Q. ARE YOU SAYING THAT THE COMPANY'S REACTION TO DEREGULATION AND THE INTERSTATE ALLOCATION SHORTFALL WAS UNREASONABLE?

A. Yes and no. Viewed from the perspective of the Company's shareholders, the reaction to these concerns was understandable and probably reasonable. However, viewed from the perspective of captive Utah ratepayers it was neither reasonable nor acceptable. While I sympathize with the Company's predicament in dealing with conflicting perspectives and needs, the Company elected to protect the interests of its shareholders at the risk of its captive ratepayers.

This result is particularly troublesome and inappropriate with respect to the interjurisdictional allocation issue. Both PacifiCorp and ScottishPower were specifically required, and agreed, to assume the risks of inconsistent interstate allocation methodologies. The Commission's 1988 order authorizing the PacifiCorp/Utah Power merger specifically required: "The Merged Company shall agree that PacifiCorp shareholders shall assume *all risks* that may result from less than full system cost recovery if inter-divisional allocations methods differ among the Merged Company's various jurisdictions." (Order, September 28, 1988, Docket 87-035-27, page 97) (Emphasis added)

In 1998, PacifiCorp and ScottishPower entered into a stipulation with the Division to secure its support for the ScottishPower/PacifiCorp merger, in which they again agreed to bear this risk: "ScottishPower and PacifiCorp agree that they shall assume *all risks* that may result from less than full system cost recovery if interjurisdictional allocation methods differ among PacifiCorp's various state jurisdictions." (Stipulation, Docket 98-2035-04, paragraph 45) (Emphasis added) This commitment was made *after* the Utah Commission's July 1998 order adopting a rolled-in interstate allocation methodology. Accordingly, ScottishPower knowingly accepted the risk *and known fact* of inconsistent interstate allocations, yet promptly set about to foist that risk right back onto the shoulders of ratepayers by refusing to pursue prudent or least-cost resource planning until it first could obtain assurances that the interstate allocation shortfall would be resolved. Unless PacifiCorp and ScottishPower are held accountable for protecting their shareholders at the risk of captive ratepayers in the face of burgeoning Utah load growth and impending resource deficits on the east side of the system, they will have succeeded in turning their merger commitments on their heads and shifting the financial consequences of the assumed risk of inconsistent interstate allocations back onto Utah ratepayers.

Q. WHAT WAS THE ULTIMATE RESULT FOR RATEPAYERS OF THE LACK OF PROPER PLANNING BY THE COMPANY IN THE LATE 1990S AND EARLY 2000S?

A. The failure to move in a timely manner to build new resources to meet the surging load growth in Utah resulted in critical and costly delays – a mistake for which ratepayers are now being asked to pay. If the Company had not forestalled its decisions and actions, the timing and the types of resources developed or acquired could and would have been different and less costly. There would have been no need to renew the expensive affiliate lease for the West Valley peakers for the test year and the Currant Creek project would not have been necessary. Instead, the Company could have developed the Lake Side project or another similar resource (perhaps any one of the 20 or so bids that were identified in public Lake Side testimony with superior economics to Currant Creek) at an earlier date. Even shaving just one year off of the time table for a Lake Side-type project would have eliminated the need for the extended West Valley lease and the Currant Creek project, and would have also offset significant market purchases that will now be necessary during the test year. Such a course of action would have produced a sufficient level of generation resources within the 'Utah Bubble' to eliminate its Tier-1 position. A timelier course of action would have resulted in substantially lower costs than those projected by the Company for the future test year.

The Commission has previously recognized the considerable risk that the Company chose to foist upon its captive ratepayers by its reluctance to commit to long-term resources in a timely manner. In finding a need for the construction of the Currant Creek project in 2004, the Commission noted:

> We find the magnitude of deficiency considerable, and as the Division

> testifies, we realize this is not new. The Company's reliance on the wholesale market for meeting this need since the time it filed its IRP "RAMPP-5" in 1997, has placed the Company and its customers at considerable risk of the high cost for purchases or reduced reliability. We commend the Company for changing its planning strategy, for producing a viable plan and for moving forward on filling the capacity deficit created by past planning policy and business decisions. (Report and Order, March 5, 2004, Docket 03-035-29, page 10)

While the Company is to be commended for finally producing a viable plan and moving forward in 2003 and 2004, it must also bear at least a significant part of the responsibility for the "capacity deficit created by past planning policy and business decisions."

Q. ARE YOU BEING A "MONDAY MORNING QUARTERBACK" IN CRITICIZING THE COMPANY'S CHOSEN COURSE OF RESOURCE DEVELOPMENT?

A. Not at all. In the first place, an after-the-fact prudence review is the only avenue currently available for ratepayers to evaluate the prudence of the Company's actions. I am analyzing the prudence of the Company's actions from the perspective of facts and information known by or reasonably available to the Company at the time its decisions were made and its course of action was selected. Simply stated, the excessive test year costs for the extended West Valley lease and the Currant Creek plant would not have been necessary had the Company paid proper attention to planning in the last half of the 1990s and the early years of this decade and given a more proper balance of consideration to ratepayer interests rather than being singularly focused on shareholder interests.

The remarkable projected Utah capacity deficits should never have materialized. There was no event in Utah that caused a sudden or unforeseeable surge in load growth. Quite to the contrary, economic growth and load growth in the state were both consistent and substantial from the mid-1990s to the current. While the state's economy has slowed somewhat in the most recent years, its economic vitality throughout the 1990s and the economic indicators admittedly relied upon by the Company should have served notice to the Company that the level and composition of the state's load was increasing and changing. As demonstrated by the actual Company data reported in the Utah Foundation report, the Company either failed to plan efficiently or simply chose to ignore the economic signals due to overriding shareholder concerns.

The current forecasted capacity deficit, thus, results from the Company's own past mistakes. The plant additions that are predicated on these mistakes should not be assigned as the burden of ratepayers.

Q. WHAT LEVEL OF DISALLOWANCE ARE YOU PROPOSING FOR IMPRUDENCE IN THE COMPANY'S RESOURCE PLANNING AND PROCUREMENT?

A. I propose a reduction in allowed expenses of $12.8 million, an increase in rate base of $80.1 million and an increase in sales revenue of $7 million, resulting in a decrease to the Company's proposed Revenue Requirement of $16.4 million.

This is a conservative estimate of the excess costs caused by the company's actions and imprudence as to timing and pursuit of resources. This recommendation is based upon an analysis conducted by Mr. Townsend, as explained in his testimony.

Q. UAE HAD A NUMBER OF CRITICISMS RELATING TO THE RFP 2003-A PROCESS, BID CATEGORIZATION, BID ANALYSIS, AND BIDDER NEGOTIATIONS IN THE CURRANT CREEK CC&N PROCEEDING. ARE YOU PROPOSING A DISALLOWANCE RELATING TO ANY OF THESE PROBLEMS?

A. Various witnesses, including some sponsored by UAE, testified in the Currant Creek docket about numerous perceived problems with the Currant Creek RFP processes. We have not proposed any disallowances stemming from these problems because my proposed adjustment essentially assumes that the Currant Creek problems were avoided and that a timely, effective process was utilized to select and secure a more efficient resource by the beginning of the test year.

IV. UNSUPPORTED FORECASTS

Q. PLEASE DESCRIBE YOUR CONCERNS OVER THE COMPANY'S FORECAST OF FUTURE VALUES

A. Anytime revenues, expenses and quantities are forecasted many months into the future, concerns arise over the accuracy of the forecasts. I believe it is for this reason that the Commission has typically expressed a preference for using actual values from historic test periods. The parties have stipulated to the use of a future test period in this case, in part to permit a "pilot" analysis of the 20-month advance projections allowed, but not mandated, by Utah law. It is critical, in this pilot or experiment, that all of the Company's forecasts be carefully examined. Unfortunately, the reality of budget constraints prevents UAE from conducting a detailed analysis of all of the Company's forecasted values. We have, however, generally reviewed the Company's projections and identified some areas of concern. For example, we question the Company's projected capital structure and propose an adjustment. We also question other projections, such as employee count and labor costs.

Q. PLEASE DESCRIBE YOUR CONCERN OVER PACIFICORP'S FORECASTED TEST YEAR EQUITY PORTION OF ITS CAPITAL STRUCTURE?

A. PacifiCorp's projections suggest an increase in the weighted average cost of capital (WACC) when compared to the current WACC, which creates a higher revenue requirement.

Q. HOW DOES THE COMPANY EXPLAIN ITS PROJECTION?

A: PacifiCorp Witness Bruce Williams in Exhibit BNW-4 provides the Company's electric operations projected capital structure for Fiscal Year 2005 (FY 05) and Fiscal Year 2006 (FY 06). It should be noted that FY 05 data includes nine months of 2004 data and three months of 2005 data, so part of the FY05 capital structure contains actual data. FY 06 uses only projected data. Exhibit BNW-4 shows an increase in the equity portion of the Company's capital structure of 3.6%, or 360 basis points. Equity of 45.9 % in FY 05 increases to 49.5% in FY 06, for an increase of approximately 8%. The Company proposes to use an average of its projected capital components for FY05 and FY06 to determine its capital structure for the rate recovery period. The Company recommends the weights for long term debt, preferred stock and common equity of 51.0 percent, 1.2% and 47.8% respectively.

Q. WHAT WOULD THE IMPACT OF THIS INCREASE IN EQUITY BE ON REVENUE REQUIREMENT?

A. Any increase in equity in the capital structure will increase the WACC and the revenue requirement, because the cost of equity generally exceeds the cost of debt. The higher return for equity is intended to compensate for the fact that equity bears more risk than debt.

Q. HOW DID THE COMPANY JUSTIFY ITS PROJECTED INCREASE IN EQUITY?

A. It did not attempt to justify it. The testimony contains no explanation for the

Company's projection of increased equity in its capital structure.

Q. IN THE ABSENCE OF A CONVINCING JUSTIFICATION FOR INCREASED EQUITY, SHOULD THE COMPANY'S PROJECTION BE ACCEPTED?

A. No. There is no reason to accept a projected increase in equity in the absence of a compelling explanation as to why the higher cost to ratepayers would be justified.

Q. WHAT DO YOU PROPOSE?

A. I propose that the Commission use a hypothetical capital structure for determining the WACC for the Company, as has been traditionally done by the Commission in the past. A review of prior rate cases indicates that the Commission adopted hypothetical capital structures in Docket Nos. 97-035-01, 99-035-10 and 01-035-01. In the last rate case, Docket No. 03-2035-02, the parties presented a stipulated capital structure, but the stipulation states that it is of no precedence in other cases. Any departure from the Commission-approved use of hypothetical capital structures should be made only upon a clear showing of the need or basis for such a change. No such showing has been made or attempted in this case.

Q. WHAT IS YOUR UNDERSTANDING OF HOW A HYPOTHETICAL CAPITAL STRUCTURE SHOULD BE CALCULATED?

A. A reading of past rate case orders reveals that the Commission has adopted the average capital structure of the firms used in the representative sample of utilities for purposes of calculating ROE. This approach has the obvious advantage of consistency between the firms used to evaluate ROE and capital structure. Without such a consistency check, a capital structure could yield a WACC that was too high or too low.

Q. WHAT IS THE AVERAGE CAPITAL STRUCTURE OF THE REPRESENTATIVE SAMPLE OF UTILITIES USED BY THE COMPANY IN CALCULATING ITS PROPOSED ROE?

A. The average capital structure for the representative firms used by the Company is 46.2% common equity, 1.1% preferred equity and 52.7% debt, as reflected in Exhibit UAE 1.10 (RMA-10). I propose the use of this capital structure in this case.

Q. IF THE COMMISSION CHOOSES NOT TO RELY ON A HYPOTHETICAL CAPITAL STRUCTURE AS IT HAS IN THE PAST, WHAT DO YOU RECOMMEND?

A. Absent a compelling justification of a need for a drastic increase in the projected equity portion of the company's capital structure from FY 05 to FY 06, the Commission should use the Company's projected FY05 capital structure of 52.8% for long term debt, 1.2% for preferred equity and 46% for common equity.

Q. WHY ARE YOU CONCERNED OVER THE COMPANY'S PROJECTED LABOR COSTS?

A. On a general level, UAE is leery of using forecasted values, particularly if they are not well substantiated. Specifically, labor is a concern because labor is generally regarded as a variable input; a firm can normally increase or decrease the number of workers fairly readily. Once a cost level has been set in a rate case, the Company has an incentive to try to lower those costs to add to its bottom line. The regulatory concern is that projected labor costs may be over stated but included in rates nonetheless. The Company can then lower its labor costs by reducing its number of employees. This can occur even when rates are set based on historic test year values, but it would at least require physical changes from actual test year values. With forecasted values, savings can be achieved without even changing actual employee counts or costs. The Company simply does not increase employee count or costs as projected.

Q. ARE YOU AWARE OF ANY INSTANCE IN WHICH EMPLOYEE LABOR COUNT WAS REDUCED FOLLOWING A RATE CASE?

A. Yes. It is my understanding that in a Questar rate case, Docket No. 99-057-20, the Commission granted a rate increase to Questar which included some wage increases as part of the known and measurable changes. However, after the new rates went into effect, Questar announced an early retirement program to reduce the number of employees.

Q. HAVE YOU IDENTIFIED ANY SPECIFIC CONCERN ABOUT THE COMPANY'S PROJECTED LABOR COST ESTIMATES?

A. There are two basic components for determining basic labor costs, the wage and the number of employees. I have concerns about both. The projected wage increases for union employees can often be substantiated because they are contractual. The nonunion wage increases are based on budget projections which are more variable. The Company's projected wages increases, ranging from 2.75% to 3% per year, should not be accepted unless they are substantiated to a greater degree.

Q. WHAT ABOUT THE PROJECTED NUMBER OF EMPLOYEES?

A. According to Company exhibit JTW 4.17.6, the head count for employees as of March 2004 was 6090. For FY05 the projected head count jumps to 6445, a 6% increase. For FY 06 the projected head count is 6578, for another 1.9% increase. The Company's testimony does not explain the reasons for the large jump in employees in FY05. The Company's projected increase in employees should be rejected absent adequate support.

Q. WHAT IS YOUR RECOMMENDATION WITH RESPECT TO LABOR COSTS?

A. The Commission should exercise great caution when accepting projected cost increases in areas where costs can be easily manipulated by managerial decision. Conservative estimates of labor cost should be adopted. The Company's projected increases in labor costs, including associated pensions and benefits, should be rejected absent further support.

VI. AFFILIATE ABUSE

Q. YOU HAVE EXPRESSED CONCERN THAT SCOTTISH POWER COULD EXPLOIT AFFILIATE RELATIONSHIPS TO ITS ADVANTAGE AND TO THE DISADVANTAGE OF PACIFICORP RATEPAYERS. PLEASE EXPLAIN.

A. Anytime a regulated utility is affiliated with unregulated companies, the potential exists for cross subsidization at the expense of the captive customers of the regulated utility. Also, creative affiliate structures can be used to extract additional value from a regulated utility without providing appropriate credit to the captive customers.

A number of areas of potential concern over affiliate abuse arise from a review of the Company's filing. Among such areas of concern are incentive compensation, management fees, and the allocation of costs and savings among affiliates. While we are not proposing specific adjustments in most of these areas at this time, we may support adjustments proposed by others to eliminate affiliate cross-subsidization. .

One of the most important areas of affiliate abuse relates to income taxes. During the proceedings for approval of the ScottishPower/PacifiCorp merger, UIEC and UAE (then known as the Large Customer Group, or LCG) discovered that a creative acquisition structure proposed by ScottishPower, in combination with favorable international tax rules, might permit ScottishPower to avoid paying income taxes on all or nearly all of PacifiCorp's earnings. UAE argued that these tax savings might well represent the most significant benefits stemming from the proposed merger and that such benefits should be equitably shared between shareholders and ratepayers. The Company argued that the tax issues should not be resolved in the merger docket, that the projected level of tax saving was speculative, and that the issue should be reserved for general rate proceedings when the actual facts as to tax liabilities could be known. The Commission deferred the issue for future resolution, noting: "Only after consideration in a general rate case will it be known whether tax savings, if any materialize, should be passed through to PacifiCorp ratepayers." (Report and Order, November 23, 1999, Docket No. 98-2035-04, page 27-28)

The facts are now known; substantial tax savings have been realized, and have been retained by PacifiCorp's unregulated affiliates. As a result, while PacifiCorp's rates have been set based upon the assumption that federal and state taxes would be paid by PacifiCorp at the highest corporate rates, those expenses have not in fact been incurred. To the extent tax savings are not created by losses or adjustments stemming from unregulated activities of subsidiaries but rather directly from the creative structure used to acquire PacifiCorp, actual earnings properly attributable to PacifiCorp far exceed reported earnings, but the excess earnings are largely shielded from regulatory review because they are captured at an affiliate level.

Utah ratepayers should not be required to reimburse PacifiCorp for tax expenses that it does not incur. Unless PacifiCorp provides a reasonable basis to project that income taxes will in fact be paid on test year revenues, I propose a disallowance of projected income taxes.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.