BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power For Authority to Increase its Retail Electric Utility Service Rates in Utah and for Approval of Its Proposed Electric Service Schedules and Electric Service Regulations, Consisting of a General Rate Increase of Approximately $161.2 Million Per Year, and for Approval of a New Large Load Surcharge	)))))))))	**Docket No. 07-035-93** **DPU Exhibit No. 5.0SR**

Surrebuttal Testimony of

Mark E. Garrett

REVENUE REQUIREMENT

For the Division of Public Utilities

Department of Commerce

State of Utah

May 23, 2008

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Surrebuttal Testimony of Mark E. Garrett

I. INTRODUCTION

1 **Q. Please state your name and occupation**.

2 A. My name is Mark E. Garrett. I am an independent consultant specializing in public utility
3 regulatory issues.

4 **Q. What is your business address?**

5 A. Two Leadership Square, Suite 340, 211 North Robinson Avenue, Oklahoma City, Oklahoma
6 73102.

7 **Q. On whose behalf are you appearing in these proceedings?**

8 A. I am testifying on behalf of the Division of Public Utilities ("Division").

9 **Q. Did you file direct testimony in this docket on April 7, 2008?**

10 A. Yes. A description of my qualifications and a list of the proceedings in which I have been
11 involved were included with that testimony.

12 II. PURPOSE OF TESTIMONY

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

14 A. My testimony presents the Division's position regarding several revenue requirement issues
15 in this case. I also explain the basis for these positions and provide analysis in support of my
16 proposed adjustments and recommendations.

17 **Q. What specific issues did you address in your direct testimony?**

18 A. I addressed Rocky Mountain Power's ("Company" or "RMP") proposed Cash Working
19 Capital Allowance (CWC), Payroll Expense, Incentive Compensation and the PowerDale
20 decommissioning.

21 **Q. In which of these areas are you providing surrebuttal testimony today?**

22 A. I am providing surrebuttal testimony in the areas of Cash Working Capital, Payroll Expense
23 (focusing on the Merit Pay, Medical Expense, and Productivity adjustments), and Incentive
24 Compensation.

25 ## III. CASH WORKING CAPITAL

26 **Q. Please describe the Company's requested allowance for Cash Working Capital?**

27 A. The Company requested a Cash Working Capital allowance of $31,688,954 for the Utah
28 jurisdiction.[1] The Company's request is based on a March 2003 lead-lag study.

29 **Q. Please provide a brief summary of your direct testimony regarding the Company's**
30 **requested CWC allowance.**

31 A. In my direct testimony I testified that the 2003 lead-lag study utilized by the Company was
32 stale and did not provide a reasonable basis for determining the Company's current CWC
33 requirements. I provided the following rationale in support of this opinion.

34 1. A utility can experience significant internal and external changes in a five
35 year period that materially impact its collection and payment practices. These
36 changes might include increased attention to slow paying customers, renegotiated
37 payment terms on important supply contracts, changes in technology such as
38 automated payment options for customers, and changes in the overall economic
39 conditions.

40 2. The Company's 2003 lead-lag study submitted in this case could not be
41 reviewed by any party. The Company provided only a summary of the results

[1] Supplemental Exhibit RMP_(SRM-1S), tab 2.33

42 from the 2003 study. The underlying data supporting the calculations were not
43 available. Without being able to trace to the original source documents –
44 invoices, cancelled checks, payment vouchers, wire transfers, contracts, accounts
45 payable journals, accounts receivable registers, etc. – an auditor cannot test the
46 validity or reliability of the calculations or the conclusions reached in the study.[2]

47 3. The Company's 2003 study has never been accepted by any commission
48 in any PacifiCorp jurisdiction. In effect, the study has been neither vetted nor
49 validated by any regulatory body. Since the study has not been accepted by any
50 commission, an auditor cannot rely on third-party validation to gain a comfort
51 level that the study was ever sufficiently tested and verified.

52 4. The burden remains with the applicant to sufficiently support its requested
53 increase for CWC.

54 5. In the absence of a current, valid lead-lag study, commissions generally
55 set the CWC allowance at zero.[3]

56 I also testified that the Commission should set a high standard for including CWC in rate
57 base to protect ratepayers against the inherent incentive that would otherwise exist for a
58 utility to turn its cash management practices into a profit center. I further said that it was
59 inconsistent for the Company to argue on the one hand that an historic test year is too out-

[2] For example, at page 4.0.4 the Study states with respect to the Accounts Payable data that "Due to the large size of the file, only the first and last pages of the report are included." Even if the entire report had been included, the original source documents would still not be available to trace and audit. (See response to DPU Data Request 22.1). Moreover, during the on-site audit, auditors were told that the PacifiCorp employee who performed the 2003 study is no longer with the Company and could not be interviewed.

[3] See Texas Rate Making Rules at §25.231(c)(2)(B)(iii)(IV). In Iowa, see 199 IAC 26.5(5)e(5). In Nevada, see Final Order in Docket 01-10001, page 31.

60 dated to use for setting prospective rates, and then, on the other hand, ask that it be allowed
61 to use a five year old lead-lag study to support a significant CWC allowance.

62 **Q. Did the Company provide any additional information in its rebuttal testimony that**
63 **changed your opinion on this issue?**

64 A. No. Mr. McDougal provided the Company's response to concerns raised regarding the age
65 of the lead-lag study used in this case to support the Company's CWC request.[4] Mr.
66 McDougal testified that the Company typically prepares a lead/lag study every five years,
67 and this study is not an exception to that rule. He further testified that in the Company's
68 1998 rate case the Commission used the Company's 1991 lead/lag study to determine the
69 appropriate CWC requirement.

70 **Q. Does the use of an older study in the 1998 rate case justify the use of the 2003 study in**
71 **this case?**

72 A. No. The problem here is that the underlying data used to support the 2003 study are no
73 longer available for audit and review. Further, the person who put the study together is not
74 available to testify regarding the authenticity and accuracy of the study. The problem is
75 further compounded by the fact that, even though PacifCorp operates in six states, the 2003
76 study has never been accepted by any commission. Thus, the Company cannot even rely on
77 third-party validation to substantiate the accuracy of its calculations. Here, there is no
78 underlying data to test, no witness with personal knowledge to cross-examine and no instance
79 were the study was accepted by a third party. The lack of verifiable support for this study is
80 a fatal flaw. Mr. McDougal does not address this shortcoming in his rebuttal testimony. He

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[4] See McDougal Rebuttal Testimony starting at page 47.

81 only points out that an older study was accepted in a previous rate case. He does not state
82 whether that study had been previously accepted by the Utah Commission, whether the
83 person conducting the study was available for questioning, whether the supporting
84 documents for that study were available for review or whether the supporting documents had
85 been previously reviewed and accepted by any other commission.

86 My testimony – that the 2003 study is unsupported with verifiable documentation – was
87 not rebutted by the Company.

88 IV. PAYROLL – MERIT INCREASE

89 **Q. Please summarize your direct testimony regarding merit increases in payroll expense.**

90 A. In my direct testimony, I testified that the Company used a scheduled pay increase of 2.25%
91 to increase total payroll costs by 2.25%. I testified that the Company's proposed adjustment
92 was deficient because the Company had not shown that its 2.25% scheduled increases
93 actually result in a 2.25% increase in payroll expense. I further testified that other events
94 over the same period could decrease payroll levels by even greater amounts. For example,
95 workforce reductions, employee turnover and changes in the capitalization percentages could
96 more than offset the anticipated increase from an annual raise. As a consequence, even if the
97 Commission were inclined to accept an adjustment to payroll levels, the Company's
98 proposed adjustment was deficient because it failed to show that net payroll expense levels
99 would actually increase by the amount of the estimated pay raise.

100 **Q. Did you provide any analysis in your direct testimony to quantify the actual impact of**
101 **the budgeted raises on payroll expense?**

102 A. Yes. I reviewed the Base Year payroll costs and the scheduled and budgeted raises for that
103 period. After adjusting the payroll data for the MEHC adjustment,[5] I looked at payroll levels
104 both before and after the scheduled raises. From this review, I found that payroll costs
105 increased for bargaining employees after the scheduled raises, but payroll costs actually
106 decreased for the three groups of non-bargaining employees after the raises were
107 implemented.[6] As a result of this finding, I recommended that the Base Year raises for
108 the non-bargaining employees be excluded from the Base Year labor annualization
109 adjustment. This adjustment reduced Base Year payroll for the first six months of the Base
110 Year for non-bargaining employees by 2.21%, which reduced Base Year payroll expenses by
111 $3,269,182 on a total Company basis, and $1,397,616 for the Utah jurisdiction.

112 **Q. Did the Company provide rebuttal testimony to your recommendations regarding the**
113 **merit pay increases?**

114 A. Yes. In his rebuttal testimony, Mr. McDougal testifies that the MEHC severance should only
115 be applied to the non-bargaining employees. Mr. McDougal also provides an alternative
116 calculation of my adjustment at Page 11.5.9 of the exhibits attached to his testimony. Mr.
117 McDougal's calculations show that the pay of officers and exempt employees increased by
118 1.67% after the pay increases were awarded. Although the 1.67% increase is less than the
119 2.25% increased used by the Company in its original exhibits, these calculations do show that
120 net payroll costs did actually increase after the raises were awarded, albeit by a lower
121 percentage.

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[5] The MEHC transition adjustment removed the costs of the workforce reduction that accompanied the purchase of PacifiCorp by MEHC.

[6] This overall decrease was the result of additional attrition among management level employees after the MEHC adjustment. As discussed above, pay raises alone are not the only factor that impact overall payroll levels. Changes in the composition of the workforce must also be taken into account.

122 **Q. What is the impact of a 1.67% base year pay increase for officers and exempt**
123 **employees on the payroll adjustment proposed by the Division?**
124 A. A 1.67% increase to base year expense would increase test year expense by $1,159,117 on a
125 Utah jurisdictional basis. The table below shows the impact of Mr. McDougal's correction
126 on my original proposed adjustment to payroll expense.

Adjustment to Correct Division Payroll Adjustment for Merit Increases

Adjustment	Division Original Adj.	Division Corrected Adj.	Difference
Merit Increase	$1,397,616	$238,499	$1,159,117

127 This correction increases the Division's recommended revenue requirement by $1,159,117.
128 **Q. Apart from the correction offered by Mr. McDougal, are there other corrections to the**
129 **Company's payroll projections that should also be recognized?**
130 A. Yes. In response to data request DPU 49.1, the Company provided a corrected capitalization
131 ratio for payroll costs. The corrected capitalization ratio is the actual capitalization
132 percentage used for the year ended December 31, 2007. The corrected ratio is higher than
133 the base year capitalization percentage used by the Company to forecast its payroll expense.
134 The corrected 2007 capitalization ratio should be used for the annualization of payroll costs,
135 since the actual 2007 capitalization percentage is closer in time to the 2008 test year and the
136 2007 capitalization ratio has been reviewed and corrected by the Company. The adjustment
137 to recognize the more current capitalization ratio decreases Utah jurisdictional payroll
138 expenses by $3,078,700, as set forth in the table below.

Adjustment to Correct RMP Capitalization Ratio for Payroll Expense			
Description	**Date**	**Ratio**	**Expense**
Payroll Expense Using Corrected Capitalization %	Jun 07	28.08%	$215,254,729
Payroll Expense Using Base Year Capitalization %	Dec 07	26.61%	$218,333,427
Division Adjustment to Recognize Corrected Capitalization %			($ 3,078,700)

139 This correction decreases the Division's recommended revenue requirement by $3,078,700.

140 **Q. What is the combined impact of the two corrections to the Company's payroll expense?**

141 A. The combined impact to the two correcting adjustments to the Company's payroll expense
142 are set forth in the table below. The net impact of these two adjustments decreases the
143 Division's recommended revenue requirement by $1,919,583.

Division Adjustments to Correct Payroll Expense	
Division Adjustment to Correct Payroll – Merit Increases	$1,159,117
Division Adjustment to Recognize Corrected Capitalization %	($ 3,078,700)
Decrease to RMP Revenue Requirement from Division Corrections	($1,919,583)

144 **Q. Have you reviewed the rebuttal testimony of Mr. Wilson related to payroll expense?**

145 A. Yes. Mr. Wilson's testimony, at lines 119 though 175, seeks to rebut my adjustment to
146 exclude the Company's proposed increases associated with the merit pay raises. In essence,
147 his testimony contends that the mitigating factors I raise in my testimony that could
148 potentially offset the effects of the pay raises could, in fact, go the other way, and increase
149 payroll costs. However, his testimony in this area is largely no longer relevant in light of the

150 fact that I have now accepted the Company's corrected merit increase calculation of 1.67%
151 for non-bargaining employees.[7]

152 **V. PAYROLL – PRODUCTIVITY ADJUSTMENT**

153 **Q. Please summarize your direct testimony regarding your proposed adjustment to**
154 **recognize labor productivity gains.**

155 A. In my direst testimony, I testified that the Company failed to consider overall improvements
156 in productivity in its proposed adjustment. I testified that these productivity improvements
157 must be considered in forward looking test years. I further testified that labor productivity is
158 the ratio of the output of goods and service to the labor hours devoted to the production of
159 this output, and that the Bureau of Labor Statistics ("BLS") indicates significant growth in
160 labor productivity over the past few years. I proposed a modest productivity adjustment of
161 only 1%, when the BLS average over the past few years has been much higher. My
162 adjustment resulted in a proposed reduction in the Company's requested payroll expense of
163 $2,404,135 at the Utah jurisdictional level.

164 **Q. Have you reviewed the rebuttal testimony of Mr. Wilson related to the productivity**
165 **adjustment?**

166 A. Yes. Mr. Wilson testified that the Company has already built increased productivity into its
167 cost structure by reflecting decreases for the CIC severance adjustment and the Automated
168 Meter Reader adjustment.

[7] We had already accepted the full increase proposed for bargaining employees.

169 **Q. Do you agree that the CIC severance adjustment and the Automated Meter Reader**
170 **adjustments replace the need for a productivity adjustment?**
171 A. No. Productivity adjustments by their very nature are forward looking only. The CIC
172 severance occurred prior to the forecast period. It cannot be used to offset a productivity
173 adjustment for that period. The Automated Meter Reader upgrades, on the other hand, will
174 occur after the base period. The savings from this adjustment, however, were about .5%,
175 when spread over the 18 month forecast period.[8] We used a conservative productivity
176 adjustment of only 1% when the BLS "business sector" average was 1.6% and the "electric
177 utility sector" average was 3.5%. Our conservative 1% factor leaves a cushion for such items
178 as the Automated Meter Reader adjustment. Bottom line, it would be unfair to ratepayers to
179 use a forecasted test year for labor costs and not include a reasonable adjustment for
180 productivity gains.

181 **VI. PAYROLL – MEDICAL EXPENSE**

182 **Q. What did the Company request with respect to future medical costs?**
183 A. The Company's forecasted test year includes $51,061,850 for Medical Plan expenses. This
184 represents a 9.8% annual increase over the annualized June 2007 expense level. To support
185 its requested increase, the Company cites a significant upward trend in healthcare costs in
186 recent years and references a statement from its consultant, Hewitt Associates, that medical
187 cost rates are anticipated to increase between 8% and 12% in 2008.
188 **Q. Please summarize your direct testimony regarding the Company's requested increase in**
189 **medical expense.**

[8] Based on Company's Meter Reading Expense adjustment of $1,698,000 over 18 months and payroll expense of $218,000,000 (from response to DPU Data Request 49.1).

190 A. In my direct testimony, I testified that in its 2008 Health Care Cost Survey, Towers Perrin
191 found that health care costs for U.S. employers are expected to increase by 6% in 2008. The
192 report states that the health care cost estimates for 2008 are the result of employer efforts to
193 aggressively manage benefit program performance. The Towers Perrin report further found
194 that high performing companies should expect medical cost increases of 5% or less. Based
195 on the comprehensive Towers Perrin survey, I recommended that rates reflect a medical cost
196 increase of 5.06% annually. I testified that, from a ratemaking perspective, and especially in
197 a situation where a forecasted test year is being used, the Company should be expected to
198 aggressively contain future medical costs. My proposed adjustment reduced the Company's
199 requested increase in medical costs by $984,164 at the Utah jurisdictional level.

200 **Q. Have you reviewed the rebuttal testimony of Mr. Wilson related to medical costs?**

201 A. Yes. At page 21 of his rebuttal testimony, Mr. Wilson testifies that the Towers Perrin report
202 is not helpful in forecasting health care costs for the Company for the following three
203 reasons: (1) only two comparably sized utilities participated in the study, (2) the Towers
204 Perrin study is geographically based, while the Company recruits from a nationwide pool,
205 and (3) the study does not address the demographic challenges facing the utility industry, in
206 particular, the aging work force. I will address each of his three objections separately.

207 **Lack of comparable utilities** – Mr. Wilson concluded from his review of the companies
208 listed at the back of the report that there were only two comparably sized utilities that
209 participated in the survey. Not only is this point not relevant, it is inaccurate. The survey
210 clearly states that the list of companies at the back is not complete. Many companies do not
211 wish to have their names included in the list. Of the 500 companies participating in the

212 survey, only about half are listed.[9] The point is not relevant because utilities are not held to a
213 lower standard than companies that operate in a competitive environment. If the expected
214 average increase for all companies is 5%, a regulated utility should be held to that standard
215 for purposes of projecting a forecasted test year.

216 **Geographically based** – The Tower Perrin survey is certainly not geographically based.
217 At page 24, the survey states that "A total of 500 employers, with operations in numerous
218 locations nationwide, responded."

219 **Aging utility workforce** – The Towers Perrin survey specifically addresses this concern.
220 In Exhibit 4, at page 3, the survey provides the expected increase in medical costs for (1)
221 active employees (2) retirees under the age of 65 and (3) retirees over the age of 65. The
222 expected increase for each of these three groups was 6%, 6% and 7% respectively. These
223 averages are for all companies. The expected increases for the high-performing companies
224 were lower. Clearly, the age of a company's workforce does not translate into higher
225 expected increases for medical costs. If this were true, the projected medical costs for the
226 older groups in the study, groups (2) and (3), retirees under the age of 65 and retirees over the
227 age of 65 respectively, would be materially higher than the expected costs for group (1),
228 active employees. Since the projected cost increase percentages for all groups are about the
229 same, it does not appear that age is a significant factor in predicting medical cost increases.[10]

230 In my opinion, the Commission should err on the side of caution when setting rates using
231 a forecasted test year. Towers Perrin has been publishing its annual survey of expected

[9] See 2008 Health Care Cost Survey at page 25. The survey can be seen at www.towersperrin.com.

[10] The higher overall medical costs of the Company's older workforce are already embedded in base year expense. What we are trying to determine here is by what percentage these costs will increase during the forecast period. The percentage increase is not higher because the workforce is older, as the Towers Perrin study bears out.

232 medical cost increases for nineteen years. The survey consists of 500 companies, most of
233 them Fortune 1000 companies.[11] From a ratemaking perspective, the Towers Perrin report
234 provides a reasonable standard for calculating medical cost increases for a forecasted test
235 year.

236 VII. INCENTIVE COMPENSATION

237 **Q. Please summarize your direct testimony regarding incentive compensation expense.**

238 A. In my direct testimony, I testified that the Company's incentive plan was subjective and did
239 not actually obligate the Company to make any incentive payments based on achieving
240 specific identifiable operational goals that benefit ratepayers. I also testified that of the
241 Company's test year incentive payments, 95% of the incentive award went to management
242 and executive level employees whose interests are more typically aligned with the interests
243 of shareholders. The employees closest to the customers received less than 5% of the
244 incentive awards. Since there had been no demonstration by the Company that any portion
245 of the incentive compensation was tied solely to the achievement of specific, quantifiable
246 customer-specific goals, I recommended that the Commission allow the Company to recover
247 the budgeted expenses for the non-exempt employees, and disallow recovery of the portion
248 attributable to exempt employees. I recommended that the Utah jurisdictional revenue
249 requirement be reduced by $9,992,677. I further testified, however, that if the Company
250 could demonstrate in rebuttal testimony a clear delineation of customer-specific goals and
251 demonstrate the amount of incentive the Company is obligated to pay if these goals are
252 achieved, I would be willing to revisit my recommendation on this issue.

[11] See 2008 Health Care Cost Survey at page 24. The survey can be seen at www.towersperrin.com.

253 **Q. Did the Company provide information in its rebuttal testimony that would change your**
254 **recommendation?**
255 A. Yes. The Company provided the performance objectives for several employees that show a
256 definite focus on operational goals – as opposed to financial goals. The Company also
257 showed that the costs of its Long-Term Incentive plan were not included in its rate request.
258 Long-term incentive plans, as opposed to annual plans for all employees, are generally
259 provided to executive level employees and are generally based on purely financial
260 performance measures. The Company properly excluded the costs of this incentive plan in
261 its application. In light of this information I believe that a portion of the costs of the
262 Company's annual incentive plan should be included in rates. However, the Company still
263 seeks to include 100% of the annual incentive plan costs.[12] This is unreasonable considering
264 that the stated performance objectives for many employees still include financial
265 performance measures.[13] Also, the individual employee performance objectives make up
266 only 70% of the total incentive weighting.[14] "Company objectives" are also considered.
267 These objectives were not explained.
268 **Q. What amount of incentive plan costs do you now recommend for inclusion in rates?**
269 A. In light of the additional information included in the Company's rebuttal testimony, I believe
270 a majority of the annual incentive plan costs should be included. The Company seeks to
271 include 100% of the costs but this seems unreasonable in light of the fact that the Company
272 does not appear to obligate itself to make any incentive payment even if performance goals

[12] In his rebuttal testimony at lines 405-406, Mr. Wilson states that "all goals are operational in nature."
[13] For example, of the few Goal Sheets that were provided for individual employees, two had entire sections devoted solely to financial performance measures. This information clearly shows that the incentive plans are not entirely based on operational measures.
[14] According to the Goal Sheets attached to Mr. Wilson's rebuttal testimony.

273 are met. This discretionary aspect of the plan would allow the Company to decrease
274 incentive payments in lean years to compensate for lower earnings. Also, the individual
275 performance objectives of some employees specifically include financial performance
276 measures. These two aspects of the plan make 100% inclusion problematic. The individual
277 Goal Sheets provided by the Company only account for 70% of the incentive weighting.
278 This leaves 30% accounted for with other "company goals." This 70/30 split seems to be a
279 reasonable sharing of the incentive costs between customers and the Company in light of the
280 problems discussed above.[15] Although not a perfect delineation, the sharing is reasonable
281 considering the Company's reluctance to move off of its position that 100% of the costs
282 should be borne by ratepayers, when clearly not all of the benefits accrue to ratepayers. The
283 table below shows the impact on the Division's recommended revenue requirement by
284 reducing the Division's initial adjustment to incentive compensation by 70%.

Division Adjustment to Correct Incentive Expense	
Division's Initial Adjustment to Incentive Expense	$9,992,677
Division's Revised Adjustment to Exclude 30% of the Annual Incentive	($ 2,997,803)
Increase to Division's Revenue Requirement from Revised Adjustment	($6,994,874)

285 **Q. Does this conclude your surrebuttal testimony at this time?**

286 A. Yes, it does.

[15] The recommendation is consistent with the Committee's adjustment to incentive compensation costs which excluded approximately 1/3rd of the costs of the annual incentive plan, leaving approximately 2/3rd of the incentive plan costs in rates.