Davison Van Cleve PC
Attorneys at Law
TEL (503) 241-7242 ● FAX (503) 241-8160 ● mail@dvclaw.com
Suite 400
333 SW Taylor
Portland, OR 97204

October 21, 2009

Via Electronic and US Mail

Public Utility Commission
Attn: Filing Center
550 Capitol St. NE #215
P.O. Box 2148
Salem OR 97308-2148

Re: In the Matter of PACIFICORP Request for a General Rate Revision
Docket No. UE 210

Dear Filing Center:

Enclosed please find the original and five (5) copies of the following testimony on behalf of the Industrial Customers of Northwest Utilities in the above-referenced docket:

Response Testimony of Michael Gorman (ICNU/500) with Exhibits (ICNU/501 – ICNU/502);

Response Testimony of Ellen Blumenthal (ICNU/600) with Exhibits (ICNU/601 – ICNU/602); and

Response Testimony of Michael Early (ICNU/700) with Exhibits (ICNU/701 – 702).

Thank you for your assistance.

Sincerely,

/s/ Brendan E. Levenick
Brendan E. Levenick

Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Response Testimony on behalf of the of the Industrial Customers of Northwest Utilities and the Citizens' Utility Board of Oregon upon the parties, on the service list, by causing the same to be deposited in the U.S. Mail, postage-prepaid, and via electronic mail where paper service has been waived.

Dated at Portland, Oregon, this 21st day of October, 2009.

Sincerely,

/s/ Brendan E. Levenick
Brendan E. Levenick

(W) PACIFIC POWER & LIGHT JORDAN A WHITE JOELLE STEWARD SENIOR COUNSEL 825 NE MULTNOMAH STE 1800 PORTLAND OR 97232 jordan.white@pacificorp.com joelle.steward@pacificorp.com	**(W) PACIFICORP** OREGON DOCKETS 825 NE MULTNOMAH ST STE 2000 PORTLAND OR 97232 oregondockets@pacificorp.com
(W) MCDOWELL & RACKNER PC KATHERINE A MCDOWELL AMIE JAMIESON 520 SW SIXTH AVE - SUITE 830 PORTLAND OR 97204 katherine@mcd-law.com amie@mcdlaw.com	**DEPARTMENT OF JUSTICE** JASON W JONES **(C)** ASSISTANT ATTORNEY 1162 COURT ST NE SALEM OR 97301-4096 jason.w.jones@state.or.us
PUBLIC UTILITY COMMISSION OF OREGON JUDY JOHNSON PO BOX 2148 SALEM OR 97301 judy.johnson@state.or.us	**(W) CITIZEN'S UTILITY BOARD OF OREGON** G. CATRIONA MCCRACKEN **(C)** GORDON FEIGHNER ROBERT JENKS **(C)** 610 SW BROADWAY - STE 308 PORTLAND OR 97205 catriona@oregoncub gordon@oregoncub.org bob@oregoncub.org
(W) CABLE HUSTON BENEDICT ET AL J LAURENCE CABLE RICHARD LORENZ 1001 SW 5TH AVE STE 2000 PORTLAND OR 97204-1136 lcable@chbh.com rlorenz@cablehuston.com	**(W) KLAMATH WATER USERS ASSOCIATION** GREG ADDINGTON 2455 PATTERSON ST - STE 3 KLAMATH FALLS OR 97603 greg@cvcwireless.net

(W) PORTLAND GENERAL ELECTRIC RANDALL DAHLGREN 121 SW SALMON ST 1WTC 0702 PORTLAND OR 97204 pge.opuc.filings@pgn.com	**(W) PORTLAND GENERAL ELECTRIC** DOUGLAS C TINGEY 121 SW SALMON 1WTC13 PORTLAND OR 97204 doug.tingey@pgn.com

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 210

In the Matter of	)
	)
PACIFICORP, dba PACIFIC POWER	)
	)
Request for a General Rate Revision.	)

RESPONSE TESTIMONY IN OPPOSITION TO THE STIPULATION

OF MICHAEL P. GORMAN

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

October 21, 2009

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140, Chesterfield, MO 63017. I am employed by the firm of Brubaker & Associates, Inc. ("BAI"), regulatory and economic consultants with corporate headquarters in Chesterfield, Missouri.

Q. ARE YOU THE SAME MICHAEL P. GORMAN WHO FILED OPENING TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE SUBJECT MATTER OF THIS TESTIMONY?

A. I will provide testimony in opposition to the recommended return on equity and capital structure contained in the joint revenue requirement Stipulation ("Stipulation") and respond to the Reply Testimony of PacifiCorp.

Q. ARE YOU SPONSORING ANY EXHIBITS IN CONNECTION WITH THIS TESTIMONY?

A. Yes. I am sponsoring Exhibits ICNU/501 and ICNU/502.

Q. PLEASE SUMMARIZE YOUR POSITIONS.

A. My positions are summarized as follows:

- First, the revenue requirement Stipulation return on equity of 10.125% should be rejected. I continue to recommend that a return on equity of 10.0% be adopted for setting PacifiCorp's rates in this proceeding.
- There has been a significant recovery and improvement in capital markets, and a lowering of utilities' cost of capital, throughout the term of this rate proceeding. Currently, market cost of capital for utility debt is lower than it was at the time PacifiCorp was last awarded a 10.0% return on equity in Docket No. UE 179. These

lower capital market costs strongly support my 10.0% return on equity in this proceeding.

- The settlement capital structure consisting of a 51% common equity ratio. This common equity ratio overstates the common equity ratio for PacifiCorp using a reasonable projection of growth to its retained earnings during the projected test year. As such, I recommend the capital structure included in the joint revenue requirement stipulation be modified as set forth below.

TABLE 1
ICNU Proposed Capital Structure

Description	Percent of Total Capital
Common Equity Ratio	50.2%
Preferred Stock Ratio	0.3%
Long-Term Debt Ratio	49.5%
Total Regulatory Capital Structure	100.0%

Source: ICNU/501.

This capital structure is based on the Company's proposed capital structure, but adjusted for the same retained earnings adjustment I proposed in my opening testimony. I believe that this is the best estimate of PacifiCorp's actual capital structure during the test year.

Q. WHAT IS THE REVENUE IMPACT OF YOUR PROPOSED ADJUSTMENT TO THE RETURN ON EQUITY AND CAPITAL STRUCTURE TO THE SETTLEMENT TERMS AND CONDITIONS?

A. Adjusting the stipulated settlement revenue requirement to reflect a 10% return on equity rather than 10.125%, and adjusting the capital structure to reflect a 50.2% common equity ratio rather than a 51.0% common equity ratio, would lower the overall rate increase by $5.5 million.

PARTIAL STIPULATION RATE OF RETURN

Q. DO YOU BELIEVE THE COMMISSION SHOULD ADOPT THE RATE OF RETURN INCLUDED IN THE PARTIAL SETTLEMENT IN THIS PROCEEDING?

A. No. The settlement includes a return on common equity of 10.125%, which is higher than the midpoint of a reasonable return on equity estimated range for PacifiCorp in this proceeding. As noted in my direct testimony, I recommend that PacifiCorp's return on equity be set at 10.0%. I would note that capital market costs have declined materially since I estimated the return, and the 10.0% return I recommended in my direct testimony is now very conservative. Therefore, PacifiCorp's return on equity should not be set any higher than 10.0%.

Q. PLEASE OUTLINE THE LAST AUTHORIZED OVERALL RATE OF RETURN PACIFICORP WAS AWARDED.

A. In response to ICNU data request ("DR") 16.1, PacifiCorp identified its last authorized overall rate of return be based on a capital structure and return on equity as set forth in the table below.

TABLE 2

Capital Structure UE 179

Capital Component	Percent Capitalization	Cost	Weighted Cost
Long-Term Debt	49.00%	6.32%	3.10%
Preferred Stock	1.00%	6.30%	0.06%
Common Equity	50.00%	10.00%	5.00%
Total	100.00%		8.16%

Source: PacifiCorp response to ICNU DR16.1.

As shown above, this capital structure consists of a common equity ratio of 50%, and a return on equity of 10.0%.

Q. DO YOU BELIEVE THAT THE COMMISSION SHOULD CHANGE THE AUTHORIZED RETURN ON EQUITY FOR PACIFICORP IN THIS PROCEEDING?

A. No. At the time the Commission approved a 10.0% return on equity for PacifiCorp in Docket No. UE 179, the 13-week average "A" and "Baa" utility bond yields were 6.29% and 6.53%, respectively, as shown on my attached Exhibit ICNU/502. These bond yields from UE 179 were nearly identical to the bond yields I used in my opening testimony in this case to support my 10.0% return on equity. In this case, again as shown on page 1 of ICNU/501, the bond yields I used in my direct case were 6.46% and 7.80%. Hence, the "A" rated utility bond yields were nearly identical to those in PacifiCorp's last rate case. "Baa" utility bond yields still reflected an abnormally large spread over "A" utility bond yields, due to distressed market conditions that prevailed earlier this year.

Market conditions, however, have improved significantly, and utility cost of capital has declined significantly. The current "A" rated utility bond yield, as shown on ICNU/501, is 5.68%. This is nearly an 80 basis points decline to the bond yields that existed at the time I developed in my testimony, and a 60 basis points decline since the time PacifiCorp was last awarded a return on equity of 10.0%.

Similarly, "Baa" utility bond yields have also declined significantly. The current "Baa" utility bond yields for a 13-week period ending October 9, 2009, are now 6.35%. This is nearly 150 basis points lower than the yields at the time I filed my opening testimony in this proceeding and is now lower than the bond yields that prevailed at the time PacifiCorp was last awarded a 10.0% return on equity.

These utility bond yields represent a significant recovery in the capital markets for utility securities. Since capital market costs have dropped significantly over the last six to nine months, and are now more in line with capital market costs that existed at the time of PacifiCorp's last rate filing, PacifiCorp's return on equity in this case should be no higher than it was in its last case.

Q. DID PACIFICORP WITNESS MR. BRUCE WILLIAMS CRITICIZE YOUR PROPOSED CAPITAL STRUCTURE IN THIS CASE?

A. Mr. Williams takes issue with my modification to the Company's projected increase in retained earnings in developing a capital structure used to set rates in this case.

Q. WHAT IS THE ISSUE CONCERNING THE DEVELOPMENT OF A FORECASTED LEVEL OF RETAINED EARNINGS USED TO SET RATES IN THIS PROCEEDING?

A. In PacifiCorp's filing, it forecasted a level of increased retained earnings from the end of 2008 to the end of 2009, using an assumed return on equity of approximately 10.0%. This return on equity assumption was much higher than PacifiCorp's filing stating what its earned return on equity would be without rate relief. As such, I adjusted PacifiCorp's projected retained earnings component of common equity which was inflated. Indeed, its earning projection contradicts its claim that a rate increase is needed.

In response, Mr. Williams asserted that the return on equity assumption I made reflected only the Oregon jurisdiction, and not the five other jurisdictions that PacifiCorp currently does business in. Therefore, he asserts that the earnings, without the rate relief return I used, is not based on consolidated Company earnings capital structure ratios. He argues that it is consolidated Company earnings that are relevant in projections. His second argument is that the determination of the expected increase in retained earnings should be based on a return on equity for the end-of-year capital structure and not beginning-of-year capital structure. He asserts that, if the end-of-year capital structure is used, then the return on equity reflecting the Company's projected increase in retained earnings is only 8.8%. PPL/307, Williams/4-5.

Q. DO YOU AGREE WITH MR. WILLIAMS' ARGUMENTS ABOUT THE REASONABLENESS OF THE COMPANY'S PROJECTED INCREASE IN RETAINED EARNINGS?

A. No. While it is true that I relied on the Company's filings to determine what its projected earned return on equity is at current rates was only related to its Oregon jurisdiction, the Company has provided no evidence that the Oregon jurisdictional earned return on equity is not reasonably comparable to the expected return on equity for the consolidated Company.

PacifiCorp is currently engaged in rate proceedings in Oregon, Washington, Utah and Idaho. Since it is seeking rate relief in all these jurisdictions, it is reasonable to believe that its expected earned return on equity without rate relief will be lower than the return on equity likely to be awarded after rates are adjusted.

As described in my opening testimony, Mr. Williams' projected increase in retained earnings was based on a return on equity of approximately 10%. This 10% return reflects the expected growth in retained earnings from the beginning of the year to the end of the year. If the Company was already earning a 10% return on equity, little to no rate increase would be necessary in this rate proceeding, or in other jurisdictions. Hence, because Mr. Williams has overstated the projected return on equity during the historical year without rate relief, he has, therefore, overstated the projected retained earnings balance, and overstated the common equity ratio of total capital.

Second, Mr. Williams' method of estimating the return on equity in constructing its retained earnings buildup is severely flawed. In forecasting a return on the buildup in retained earnings, one must reasonably estimate what the expected earnings will be during calendar year 2009. The increase in retained earnings reflects the beginning of year 2009 relative to the end of year 2009. Mr. Williams' proposal to calculate earned return on equity and end-of-year capital structure simply does not gauge the level of expected earnings that will take place during calendar year 2009. One cannot reasonably estimate the rate of growth in investment by comparing the end-of-year investment to the value of the investment at the same end of year time period. Rather, the rate of growth in retained earnings should be measured from the beginning of the year, relative to the end of the year, to determine whether or not the estimated earnings produced during that year are reasonable.

Q. DOES MR. WILLIAMS' REPLY TESTIMONY CONTINUE TO SHOW THAT HE OVERSTATED THE PROJECTED RETAINED EARNINGS BALANCE?

A. Yes. The data at page 5 of Mr. Williams' reply testimony proves this point. PPL/307, Williams/5. Removing from the end-of-year common equity balance, the projected increase in retained earnings, and projected $125 million of equity contribution expected to be made toward the end of 2009, produces a beginning-of-year common equity balance of $6,202,627,271. Dividing Mr. Williams' projected increase in retained earnings of $590,595,729 by this balance, indicates an expected earned return on equity throughout calendar year 2009 of 9.8%. Again, Mr. Williams' projected buildup in retained earnings is unreasonably high, and his common equity component of total capital structure is inflated.

As such, I recommend the capital structure adjustment I proposed in my original testimony be adopted.

Q. WHAT CAPITAL STRUCTURE DO YOU RECOMMEND BE USED TO SET PACIFICORP'S RATES IN THIS PROCEEDING?

A. The capital structure I recommend is shown on my ICNU/501. This capital structure was developed in the same way I developed my capital structure in my opening testimony, however, it was adjusted to reflect $125 million equity issuance rather than the $200 million equity issuance that PacifiCorp was projecting at the time of my opening testimony.

<u>RESPONSE TO PACIFICORP WITNESS SAMUEL HADAWAY</u>

Q. PLEASE SUMMARIZE THE ISSUES YOU HAVE WITH DR. HADAWAY'S REPLY TESTIMONY.

A. Dr. Hadaway reviews my rate of return analysis and summarizes his conclusion at page 19 of his reply testimony. PPL/214, Hadaway/19. By outlining results of all my return on equity studies, and rejecting the CAPM studies, Dr. Hadaway incorrectly concludes that my return on equity studies support a return on equity of 10.65%.

Q. DID DR. HADAWAY RELY ON YOUR TESTIMONY IN SUPPORT OF HIS DECISION TO EXCLUDE THE CAPM RETURN ESTIMATES FROM YOUR ESTIMATED RANGE?

A. Yes. He acknowledged that my testimony was concerned with the market risk premium being abnormally low, and therefore, I recommend that minimal weight be placed on the CAPM return estimate at this time. However, Dr. Hadaway's reliance on my testimony is incomplete. I did state concern about CAPM return estimates being too low. I also found that the constant growth discounted cash flow ("DCF") model results, particularly those produced using analysts' growth rates, are irrationally high at this point in time. By excluding unreasonably low results, and relying on unreasonably high results, Dr. Hadaway is producing an excessive return on equity by selectively using the results of my studies.

The simple arithmetic average of all my DCF return studies as shown in Table 3 below, produces a return on equity of approximately 10.0%. Hence, including all my equity return estimates including those I found to be unreasonably high, and those I found to be unreasonably low, supports my return on equity recommendation of 10.0%. Further, as noted above, more recent market data shows that capital costs have decreased since I filed my opening testimony. Hence, my recommended return on equity of 10.0% is now very conservative and likely higher than PacifiCorp's current market cost of equity capital.

TABLE 3

Return on Equity Summary

Description	**Result**
Constant Growth DCF (Analysts' Growth)	11.68%
Constant Growth DCF (Sustainable Growth)	10.62%
Multi-Stage Growth DCF Model	10.96%
Risk Premium (Treasury Bond)	9.84%
Risk Premium ("A" Bond)	10.17%
CAPM (Current Market Risk Premium	8.73%
CAPM (Historical Risk Premium)	8.41%
Average of All	10.05%

Q. DID DR. HADAWAY TAKE ISSUE WITH ANY ASPECT OF YOUR DCF STUDIES?

A. Yes. Dr. Hadaway continues to assert for the use of a Gross Domestic Product ("GDP") growth rate in a multi-growth stage DCF analysis, that significantly exceeds the general consensus of market outlooks. Dr. Hadaway advocates for use of a GDP growth rate of 6.2%. PPL/214, Hadaway/22. Reaching this GDP growth forecast, Dr. Hadaway relies on a methodology he offers in his testimony, but does not show that this GDP growth outlook is consistent with any publically available or market participant expectation of future GDP growth.

For use in a DCF analysis, it is necessary to show that the GDP growth outlook is generally consistent with market outlooks. Dr. Hadaway makes no such demonstration.

In significant contrast, the GDP growth forecast I used was based on a consensus of professional economists' published GDP growth forecasts over the next 5 and 10 years. My GDP growth rate forecast is based on *The Blue Chip Economic Indicators*', and *Blue Chip Financial Indicators*' published growth rate estimates. As such, information I relied on is based on market participants and likely to be more reflective of general market expectations than is a non-public forecast produced by Dr. Hadaway in his return on equity testimony. Hence, since the point of this testimony is to capture the market's assessment of future growth, it is more reasonable to rely on independent economists' consensus projections to capture what the likely consensus expectation is in the marketplace, rather than to rely only on Dr. Hadaway's perspective.

Q. DID DR. HADAWAY ALSO TAKE ISSUE WITH YOUR RISK PREMIUM STUDY?

A. Yes. He believes that my use of historical data in relationship to current bond yields is not appropriate unless I perform a regression analysis in comparison to historical equity returns and current bond yields. I disagree. Further, he argues, erroneously, that I previously accepted his belief that there is a simple inverse relationship between equity risk premiums and interest rates. I will show that both of his arguments are incorrect.

Q. DID YOU SIMPLY APPLY YOUR HISTORICAL DETERMINED EQUITY RISK PREMIUMS TO BOND YIELD WITHOUT AN ASSESSMENT OF AN APPROPRIATE EQUITY RISK PREMIUM BASED ON CURRENT MARKET INFORMATION?

A. No. Indeed, based on theoretical studies, I gauged the relative perception of risk of utility investments in determining an appropriate equity risk premium. I did this by looking at current interest rate spreads. Currently, "A" utility bond spreads have recovered substantially from very wide spreads that existed over the last six months. Indeed, "A" utility bond spreads are now approximately below the average of what they have been over the last 30 years. This suggests that an equity risk premium for a utility stock investment should be reasonably consistent with the average equity risk premium estimated over this long historical time period. Further, 30-year Treasury bonds have increased considerably, thus, indicating a return to more normal conditions, and a reversal of the flight to quality that has been experienced over the last six months. Again, this indicates that equity risk premiums have now returned to more normal levels consistent with the last 20 to 30 years.

Hence, my conclusion to use certain equity risk premiums is based on: 1) my observation that utility bond yield spreads have returned to more normal levels; 2) that bond yield spreads are a reasonable gauge to assess the market's industry risk for electric utilities; and 3) when bond yield spreads are normal, then the equity risk premium should be generally consistent with average levels.

Q. DR. HADAWAY ALSO ASSERTED AT PAGE 25 OF HIS REPLY TESTIMONY, THAT YOU AT ONE TIME ADOPTED HIS BELIEF THAT THERE IS AN INVERSE RELATIONSHIP BETWEEN EQUITY RISK PREMIUMS AND INTEREST RATES?

A. No. Dr. Hadaway's argument is disingenuous and erroneous. In the quote in his testimony, he observed that I one time measured the relative risk assessment of the market for the utility industry based on the "real return" spread between interest rates and equity risk premiums. This is not the same analysis that Dr. Hadaway performs by comparing the "nominal" interest rate spreads and equity risk premiums. Indeed, when real interest rate spreads increase, perceptions of risk are higher. Conversely, when real return spreads contract, perceptions of risk decline. In other words, the analysis I had performed previously in Texas complements the analysis I have done here because it assigns an equity risk premium based on the relative market perception of investment risk for the electric utility industry in selecting appropriate equity risk premium. Dr. Hadaway's arguments are simply misleading and erroneous.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

A. I recommend a return on equity no higher than 10%, and a capital structure of 50.2% common equity ratio which reduces the revenue requirement by $5.5 million on an Oregon basis.

Q. DOES THIS CONCLUDE YOUR RESPONSE TESTIMONY?

A. Yes, it does.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 210

In the Matter of	)
	)
PACIFICORP, dba PACIFIC POWER	)
	)
Request for a General Rate Revision.	)

ICNU/501

RATE OF RETURN

OCTOBER 21, 2009

PacifiCorp Oregon

Rate of Return

Line	Description	Weight (1)	Cost (2)	Weighted Cost (3)
1	Long-Term Debt	49.5%	5.96%	2.95%
2	Preferred Stock	0.3%	5.41%	0.02%
3	Common Equity*	50.2%	**10.00%**	5.02%
4	**Total**	**100.0%**		**7.99%**

Source:
Exhibit PPL/300 at 3.
* Adjusted to reflect additional retained earnings of $387 million based on 2009 return on equity of 6.5%, and reduced capital contribution of $125 million.

PacifiCorp Oregon

Rate of Return
(Common Equity Balance)

Line	Description		Amount (1)	Reference (2)
1	Common Equity*	$	5,945,627,271	See Note.
2	Return on Equity Before the Increase		6.517%	Exhibit PPL/701.
3	Increase in Earnings	$	387,476,529	Line 1 x Line 2.
4	Common Equity	$	6,333,103,800	Line 1 + Line 3.
5	Equity Contribution**	$	125,000,000	See Note.
6	Adjusted Common Equity	$	6,458,103,800	Line 4 + Line 6.

Notes:
* PacifiCorp's Response to ICNU Data Request 2.12.
** Stipulation Agreement.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 210

In the Matter of	)
	)
PACIFICORP, dba PACIFIC POWER	)
	)
Request for a General Rate Revision.	)

ICNU/502

UTILITY BOND YIELDS

OCTOBER 21, 2009

PacifiCorp Oregon

Utility Bond Yields
(Summary)

Line	13 Weeks Ending	Period (1)	"A" Rating Utility Bond Yield (2)	"Baa" Rating Utility Bond Yield (3)
1	10/09/09	Current	5.68%	6.35%
2	06/19/09	UE-210	6.46%	7.80%
3	09/08/06	UE-179	6.29%	6.53%

Sources:
Gorman/2 to Gorman/4

PacifiCorp Oregon

Utility Bond Yields
(Current)

Line	Date	"A" Rating Utility Bond Yield (1)	"Baa" Rating Utility Bond Yield (2)
1	10/09/09	5.60%	6.20%
2	10/02/09	5.39%	6.00%
3	09/25/09	5.43%	6.01%
4	09/18/09	5.58%	6.15%
5	09/11/09	5.52%	6.11%
6	09/04/09	5.62%	6.24%
7	08/28/09	5.56%	6.19%
8	08/21/09	5.73%	6.38%
9	08/14/09	5.72%	6.36%
10	08/07/09	5.89%	6.52%
11	07/31/09	5.68%	6.45%
12	07/24/09	6.02%	6.89%
13	07/17/09	6.08%	7.00%
14	**13-Wk Average**	**5.68%**	**6.35%**

Source:
www.moodys.com, Bond Yields and Key Indicators.

PacifiCorp Oregon

Utility Bond Yields
(UE-210, from ICNU-CUB/317)

Line	Date	"A" Rating Utility Bond Yield (1)	"Baa" Rating Utility Bond Yield (2)
1	06/19/09	6.14%	7.17%
2	06/12/09	6.30%	7.36%
3	06/05/09	6.41%	7.58%
4	05/29/09	6.32%	7.56%
5	05/22/09	6.58%	7.85%
6	05/15/09	6.34%	7.63%
7	05/08/09	6.60%	7.83%
8	05/01/09	6.59%	7.90%
9	04/24/09	6.50%	7.94%
10	04/17/09	6.56%	8.09%
11	04/09/09	6.53%	8.16%
12	04/03/09	6.54%	8.21%
13	03/25/09	6.56%	8.18%
14	**13-Wk Average**	**6.46%**	**7.80%**

Source:
www.moodys.com, Bond Yields and Key Indicators.

PacifiCorp Oregon

Utility Bond Yields
(UE-179 Order Period)

Line	Date	"A" Rating Utility Bond Yield (1)	"Baa" Rating Utility Bond Yield (2)
1	09/08/06	6.07%	6.34%
2	09/01/06	6.06%	6.30%
3	08/24/06	6.13%	6.36%
4	08/17/06	6.19%	6.42%
5	08/11/06	6.31%	6.53%
6	08/04/06	6.21%	6.44%
7	07/28/06	6.29%	6.52%
8	07/21/06	6.32%	6.58%
9	07/14/06	6.35%	6.59%
10	07/07/06	6.41%	6.65%
11	06/29/06	6.51%	6.75%
12	06/23/06	6.52%	6.75%
13	06/16/06	6.42%	6.63%
14	**13-Wk Average**	**6.29%**	**6.53%**

Source:
www.moodys.com, Bond Yields and Key Indicators.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 210

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PACIFICORP, dba PACIFIC POWER	)
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RESPONSE TESTIMONY IN OPPOSITION TO THE STIPULATION

OF ELLEN BLUMENTHAL

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

October 21, 2009

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Ellen Blumenthal. My business address is 13517 Queen Johanna Court, Corpus Christi, Texas 78418.

Q. ARE YOU THE SAME ELLEN BLUMENTHAL WHO FILED OPENING TESTIMONY IN THIS DOCKET?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF THIS RESPONSE TESTIMONY?

A. A settlement has been reached by PacifiCorp (the "Company" or "PP&L") and other parties to this case. The Industrial Customers of Northwest Utilities ("ICNU") is not a party to this settlement. The settlement does not include any adjustment to the Company's projected wages and salaries costs for the test year ended December 31, 2010. I discuss the adjustment to the Company's proposed wages and salaries costs that should be included if the Oregon Public Utility Commission ("OPUC" or the "Commission") elects to adopt the settlement.

Q. WHAT LEVEL OF WAGES IS INCLUDED IN THE SETTLEMENT REVENUE REQUIREMENT?

A. The settlement revenue requirement includes the Company's forecasted 2010 wages and salaries of $528,780,909 (total company), an increase of 6.3% over the actual amount for the base year ended June 30, 2008. PacifiCorp annualized the June 30, 2008 pay levels and then applied escalation rates for both union and non-union employees.

Q. HOW DID PP&L DETERMINE OREGON'S SHARE OF THE TOTAL COMPANY FORECASTED WAGES AND SALARIES?

A. PP&L allocated 29.5% of the total Company amounts to Oregon.

Q. DO YOU DISAGREE WITH THE COMPANY'S PROPOSED 2010 WAGES AND SALARIES AMOUNT?

A. Yes, I disagree with both the total Company adjusted wages and salaries and with the portion allocated to Oregon. First, it is inappropriate to include wage and salary increases, incentive compensation and bonuses for non-union employees given the current economic situation in Oregon. Many utility customers are unemployed, have taken pay cuts in order to keep their jobs, or have had their work week shortened due to the weak economy. Second, PP&L has not met its burden of proof with regard to the wages and salaries that are included in the settlement revenue requirement for its Oregon operations.

Q. HAS THE COMPANY SUPPLEMENTED ITS RESPONSES TO THE ICNU DATA REQUESTS THAT YOU RELIED UPON IN MAKING YOUR RECOMMENDATIONS IN YOUR OPENING TESTIMONY?

A. Yes.

Q. PLEASE SUMMARIZE THE ADDITIONAL INFORMATION PACIFICORP PROVIDED IN ITS SUPPLEMENTAL RESPONSES TO ICNU DATA RESPONSE ("DR") 9.8 AND 9.33. SEE ICNU/602, BLUMENTHAL/1-3.

A. In its second supplemental response to ICNU DR 9.8, the Company states:

> In the Company's original response to ICNU 9.8, the Company provided the responsive data it had available and indicated that it was incomplete because: (1) it did not reflect the allocation of FERC 707 expenses; and (2) it did not reflect the final allocation of other accounts.

According to the original response and the second supplemental response to ICNU DR 9.8, the Company began charging distribution and transmission labor to a clearing account in 2007 "as a temporary labor clearing account." The original response states that the data provided for 2007 and 2008 includes "only the total wages and salaries booked and excludes all labor allocation activity since this is considered secondary labor." However, "FERC 707 has a zero balance on a consolidated basis." PP&L is using FERC 707 as the clearing account.

In the supplemental response, PacifiCorp provides an *estimate* of the amount of labor in the clearing account that should be allocated to Oregon because including these costs impacts Oregon's share of total payroll, which I relied upon in my analyses.

Q. DID PACIFICORP UPDATE ITS ORIGINAL RESPONSE TO SHOW THE ACTUAL ALLOCATION OF THE WAGES CHARGED TO THE CLEARING ACCOUNTS FOR 2007 AND 2008?

A. No. Apparently the labor costs have still not been cleared from the clearing account for Oregon's operations. I find this failure to clear these amounts to the appropriate accounts somewhat amazing since the charges to the clearing account are "by far the largest account for labor costs." PPL/706, Dalley/42. The Company assumes that the Commission will merely rely on its budgets and estimates and that it will not be required to demonstrate that these estimates result in a reasonable and necessary level of payroll costs.

Q. HAVE THE COMPANY'S ESTIMATES IN PAST RATE APPLICATIONS RESULTED IN AN AMOUNT THAT WAS INCLUDED IN RATES THAT WAS NOT REASONABLE AND NECESSARY?

A. Yes. As I pointed out in my Opening testimony, PacifiCorp projected total wages and salaries for its future test year in Docket UE 179, the year ended December 31, 2007, would be $512,779,116. Re PacifiCorp, OPUC Docket No. UE 179, PPL/901, Wrigley/Table 4.3.1. Actual wages and salaries for calendar year 2007 were $493,221,406, approximately $20 million or 4% less than PP&L predicted.

Q. IN HIS REPLY TESTIMONY, COMPANY WITNESS DALLEY PROVIDES A TABLE AT PAGE 43 THAT REFLECTS "OREGON'S FINAL LABOR ALLOCATION PERCENTAGES FOR 2006, 2007, AND 2008 AS REPORTED IN THE COMPANY'S ANNUAL RESULTS OF OPERATIONS REPORTS FILED WITH THE COMMISSION." ARE THE PERCENTAGES SHOWN IN THIS TABLE CONSISTENT WITH THE DATA PROVIDED BY PP&L IN ITS RESPONSES TO ICNU DATA REQUESTS 9.8 AND 9.33?

A. No. It is curious that Mr. Dalley could provide "final labor allocation percentages" given the response to ICNU DR 9.8 that the costs classified in FERC 707 (the clearing account) have not yet been cleared for Oregon's operations.

Q. HAS THE COMPANY SUPPLEMENTED ITS RESPONSES TO THE ICNU DATA REQUESTS THAT YOU RELIED UPON IN MAKING YOUR RECOMMENDATIONS IN YOUR OPENING TESTIMONY?

A. Yes. In my opening testimony, I calculated that approximately 19.7% of total PP&L wages and salaries would be allocated to Oregon operations for calendar year 2010. In its second supplemental response to ICNU DR 9.8, the Company provided details of how each FERC account that wages and salaries are charged to are allocated among the states in which it operates. I have used this information to recalculate the portion of total PP&L wages will be allocated to Oregon when and if the Company finally clears the wages and salaries that are currently being held in FERC 707, a clearing account that PP&L began using in 2007.

Q. HOW DO THE PERCENTAGES SHOWN IN MR. DALLEY'S TABLE COMPARE TO THE 2006 DATA PROVIDED BY PP&L IN ICNU DR 9.8?

A. The information in Mr. Dalley's table is very different from the information provided in the response to the data request. The Company's second supplemental response to ICNU DR 9.8 shows that Oregon's allocated share of PP&L total wages and salaries for calendar year 2006 was 28.4% while Mr. Dalley's table shows 30.59%. While the wage and salary dollars for 2006 do not change in the second supplemental response to ICNU DR 9.8 for calendar 2006, there is an added cautionary statement:

> These percentages are approximations only based on data extracted from SAP before labor activity processing. The labor allocation activity must be processed to determine the final FERC account and allocator. The labor allocation activity settlement process includes wages, salaries, benefits, etc. and cannot be run for wages and salaries only.

Since PP&L did not begin to use the "clearing account" until 2007, it is not clear why this statement is included for 2006. Even if it applies to 2006, the "secondary labor settlements" for 2006 should certainly have been processed by now. One would expect the clearing account for both calendar years 2007 and 2008 to have been processed and cleared by now. Indeed, the table in Mr. Dalley's testimony implies that the FERC 707 charges have been cleared. Otherwise, the amounts in his table must be estimates just as the amounts provided by the Company in its second supplemental response to ICNU DR 9.8 are estimates.

Q. HOW DO THE PERCENTAGES SHOWN IN MR. DALLEY'S TABLE FOR 2007 AND 2008 COMPARE TO PP&L'S SECOND SUPPLEMENTAL RESPONSE TO ICNU DR 9.8?

A. Mr. Dalley's table shows that 30.1% of 2007 total PP&L wages was allocated to Oregon while the Company shows in its second supplemental response to ICNU DR 9.8 that 28.4% should be allocated. Mr. Dalley's table shows that 30.37% of 2008 total PP&L wages was allocated to Oregon while the Company shows in its second supplemental response to ICNU DR 9.8 that 28.2% should be allocated.

Q. WHAT PORTION OF PP&L'S TOTAL LABOR DID THE COMPANY ALLOCATE TO OREGON OPERATIONS FOR 2010 IN ITS FILING?

A. The Company allocated 29.5% of total Company payroll to Oregon. In his reply testimony, Mr. Dalley explains that the labor allocation to Oregon is based on "the type of work identified." PPL/706, Dalley/44. He also states that "generation and transmission labor expenses are primarily allocated using the system generation ('SG') factor," yet in its second supplemental response to ICNU DR 9.8, the Company used the "SNPD" allocator to allocate the wages and salaries included in FERC 707. The SG factor that was used to allocate wages and salaries to Oregon during 2008 was 26.877% while the SNPD factor was 28.399%. 28.2?

Q. WHAT IS PACIFICORP'S PROCESS FOR CLEARING THE AMOUNTS IN FERC 707?

A. PacifiCorp explains in its supplemental response to ICNU DR 9.8 that the labor in the clearing account is "associated with the Company's power delivery employees and will remain in FERC account 707 until the labor allocation activity is processed within the Company's accounting system (SAP)."

Q. IN WHICH FERC ACCOUNTS ARE TRANSMISSION AND DISTRIBUTION ACTIVITIES RECORDED?

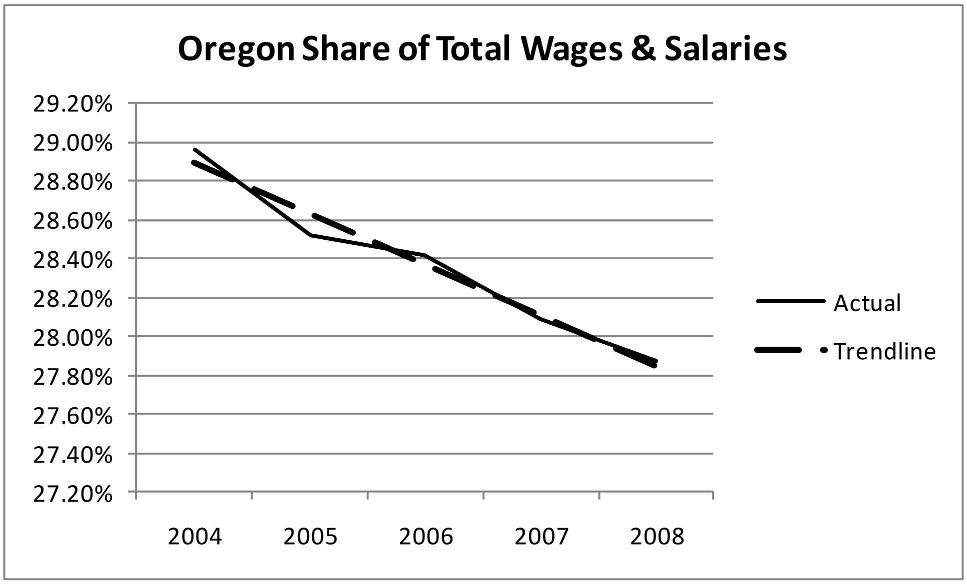
A. Transmission operations are recorded in accounts 560 though 567. Transmission maintenance accounts are recorded in accounts 568 through 574. The Distribution operations accounts are 580 through 589 and the Distribution maintenance accounts are 590 through 598.

Q. DOES THE DETAILED DATA PACIFICORP PROVIDED IN THE SUPPLEMENTAL RESPONSE TO ICNU DR 9.8 SUPPORT USING THE "SNPD" ALLOCATOR FOR ALL TRANSMISSION AND DISTRIBUTION LABOR?

A. No. Transmission operating and maintenance expenses that have been allocated (i.e., not charged to clearing or directly to Oregon) are allocated using the "SG" factor while distribution operating and maintenance expenses are allocated using the "SNPD" factor. Using the "SNPD" factor for all transmission and distribution labor that was charged to clearing during 2007 and 2008 increases the "indicated" overall percentage of payroll charged to Oregon operations.

Q. HAVE YOU RECOMPUTED THE CHARGES TO OREGON FROM THE CLEARING ACCOUNT?

A. Yes. Using the information provided in the second supplemental response to ICNU DR 9.8, I computed the portion of payroll that was allocated to Oregon in 2008 using the various allocators (SSGCT, SG, SG-P, SG-U, SO, SNPD, and CN). I then calculated the portion that was allocated using SG (including SG-P and SG-U) and the portion that was allocated using SNPD. Approximately 73% of the 2008 total wages and salaries were allocated using these two allocators. Approximately 75% of this amount was allocated using the SG allocator and 25% using the SNPD allocator. Using these percentages, I estimate that Oregon should be allocated approximately $141.667 million, or 27.8% of PP&L's total payroll for 2008. Using the same methodology, I estimate that Oregon should be allocated approximately $138.5 million, or 28.1% of PP&L's total payroll for 2007. These "minor" adjustments become important when predicting what Oregon's portion of total labor should be in mid-2010. The trendline for the years 2004 through 2008, shown in the graph below, indicates that the Company's 29.5% allocation to Oregon is excessive and that the value that should be used to calculate Oregon's rates for 2010 should be no more than 27.8%. This value could certainly be lower given the definite downward trend shown in the graph.



Q. PLEASE SUMMARIZE THE DIFFERENCES BETWEEN YOUR CALCULATION AND THE COMPANY'S CALCULATION OF THE WAGES AND SALARIES THAT SHOULD BE INCLUDED IN PACIFICORP'S RATES IN THIS CASE.

A. There are essentially three differences between my calculation and the Company's. First, I recalculated the regular, overtime, and other compensation shown on line 1 of ICNU/601 to exclude the 3.8% escalation of wages for all employees other than union employees. While the Company is contractually obligated to increase the wages for union employees through 2010, it is not obligated to increase the wages and salaries of non-union employees. Many utility customers in Oregon have had their pay lowered, their working hours shortened, or have lost their jobs. Even the state of Oregon is requiring its employees to take days off without pay during the current biennium due to budget shortfalls. Oregon's unemployment rate is 11.5% and is even higher in counties in which PP&L provides utility service.[1/] Given Oregon's economic circumstances, it is

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1/ *Unemployment Rate Falls Slightly to 11.5 Percent*, Portland Business Journal, October 12, 2009 http://portland.bizjournals.com/portland/stories/2009/10/12/daily4.html simply unconscionable to increase utility rates so that utility employees can receive wage increases at the expense of utility customers.

Second, I removed all bonus & incentive compensation shown on line 2 of ICNU/601 because of the state of Oregon's economy as discussed above. This adjustment is shown on line 4 of ICNU/601. This adjustment and the removal of wages increases for non-union employees reduce the Company's revenue requirement by approximately $7.3 million.

Third, my calculations reflect a 27.8% allocation of total PacifiCorp payroll to Oregon rather than the 29.5% used by the Company. I calculated the 2008 allocation to Oregon, as discussed earlier, to be 27.8%. I used the 2008 value because the trend over the last five years shows a steady decrease from 28.96% in 2004 to 27.8% in 2008. It is important to note that the allocation to Oregon has not been as high as the 29.5% recommended by the Company in any of the last five years.

Q. IN YOUR OPENING TESTIMONY, YOU RECOMMEND THAT WAGES AND SALARIES BE REDUCED TO REFLECT FEWER FULL-TIME EQUIVALENTS ("FTE"). IS THIS ADJUSTMENT ALSO INCLUDED IN YOUR RECOMMENDATION ON ICNU/601?

A. No. Mr. Dalley states in his reply testimony that the Company's adjusted pro forma wages and salaries expense does not include costs related to additional headcount. Based on this representation, I have made no FTE adjustment.

Q. AT PAGE 10 OF MS. GARCIA'S TESTIMONY JOINT-REVENUE REQUIREMENT/100, STAFF STATES THAT IT DID NOT SUPPORT THE PROPOSED ADJUSTMENT THAT YOU RECOMMEND IN YOUR OPENING TESTIMONY. PLEASE COMMENT.

A. Ms. Garcia, et al. state in the testimony in support of the stipulation that my recommendation was based on "incorrect assumptions . . . of historic and appropriate test year wage & salary levels." There were two items underlying my recommendations in my opening testimony: headcount and the portion of payroll charged to Oregon operations. As I have explained in this testimony, I have removed the adjustment related to headcount, and I have recalculated the portion of total Company payroll that is charged to Oregon operations based on Mr. Dalley's reply testimony and on the Company's supplemental responses to ICNU data requests. After making the necessary changes, my analyses indicate that the Company's proposed Oregon wage and salary levels, which are embodied in the stipulation, are excessive.

Q. PLEASE SUMMARIZE YOUR LABOR COST RECOMMENDATION.

A. Based on my review and analysis of the information provided by PP&L, PacifiCorp's settlement rates are overstated by approximately $21.7 million. This amount includes two components: 1) PP&L's proposed 2010 wages and salaries *expense* is overstated by $21 million; and 2) the labor and labor related costs included in plant in service should be reduced by $704,000. The labor and labor related rate base costs are overstated by $8.4 million, but the revenue requirement impact of this rate base adjustment is approximately $704,000.

Q. DO YOUR RECOMMENDATIONS INCLUDE MR. GORMAN'S COST OF CAPITAL RECOMMENDATIONS?

A. Yes, they do.

Q. WHAT IS THE REVENUE REQUIREMENT IMPACT OF THE STAFF'S RATE BASE ADJUSTMENTS THAT WERE INCLUDED IN ADJUSTMENT S-8 USING MR. GORMAN'S RECOMMENDED COST OF CAPITAL?

A. The revenue requirement impacts of each of the three parts of Staff Adjustment S-8 using Mr. Gorman's cost of capital recommendations are shown below:

	Total Company	Oregon	Staff Adjustment	ICNU WACC
Plant not in service by due date (100%) disallowance	$(131,507)	$(36,374)	$(4,281)	(4,478)
Not allowed in rate base (100% disallowance)	(1,473)	(396)	(46)	(49)
Unknown in service date (50% disallowance)	(135,971)	(79,816)	(9,395)	(9,827)
Total	$(268,951)	$(116,586)	$(13,722)	$(14,354)

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 210

In the Matter of	)
	)
PACIFICORP, dba PACIFIC POWER	)
	)
Request for a General Rate Revision	)
	)
	)

ICNU/601

WAGES & SALARY

ADJUSTMENT SUMMARY CHART

October 21, 2009

PacifiCorp
Total Wages and Salaries - Reply Testimony
Test Year Ended December 31, 2010

		PPL Proposal			ICNU Adjustments		
Wages & Salaries		Total Co		Oregon	Total Co		Oregon
1	Regular, overtime & other compensation	$ 494,351,756	29.50%	$ 145,833,768	$ 485,098,542	27.80%	$ 134,857,395
2	Bonuses & incentive compensation	34,429,153	29.50%	10,156,600	32,991,063	27.80%	9,171,515
3	Total wages & salaries	$ 528,780,909		$ 155,990,368	$ 518,089,605		$ 144,028,910
4	ICNU bonus & incentive compensation adjustment				(32,991,063)	27.80%	(9,171,515)
5	ICNU recommended wages & salaries				$ 485,098,542		$ 134,857,395
6	Non-utility & capital	(150,965,900)		(44,534,940)	(138,494,671)	27.80%	(38,501,519)
7	Wages & Salaries Expense	$ 377,815,010		$ 111,455,428	$ 346,603,871		$ 96,355,876
Pensions & Benefits							
8	Total Pensions & Benefits	$ 170,119,604	29.50%	$ 50,185,283	$ 156,066,095	27.80%	$ 43,386,375
9	Correct Enhanced 401K amount per OPUC 206	(6,919,258)	29.50%	(2,041,181)	(6,919,258)	28.26%	(1,955,382)
10	Corrected total pensions & benefits	$ 163,200,346		$ 48,144,102	$ 149,146,837		$ 41,430,992
11	Non-utility & capital	(48,568,809)		(14,327,799)	(44,556,560)	27.80%	(12,386,724)
12	Pensions & Benefits Expense	$ 114,631,537		$ 33,816,303	$ 104,590,277		$ 29,044,268
Payroll Taxes							
13	Total payroll taxes	$ 38,701,452	29.50%	$ 11,416,928	$ 35,504,342	27.80%	$ 9,870,207
14	Non-utility & capital	(11,049,188)	29.50%	(3,259,510)	(10,136,419)	27.80%	(2,817,924)
15	Payroll tax expense	$ 27,652,264		$ 8,157,418	$ 25,367,923		$ 7,052,282

UE-210/PacifiCorp
August 14, 2009
ICNU 9th Set Data Request 9.8 – 2nd Supplemental

ICNU Data Request 9.8

Provide the following information for Pacific Power Oregon for each of the calendar years 2008, 2007, 2006, 2005, and 2004:

a. Total wages and salaries
b. Total wages and salaries charged to accounts 500 through 932
c. Total wages and salaries charged to capital or other balance sheet accounts
d. Total regular wages and salaries
e. Total overtime wages and salaries.

2nd Supplemental Response to ICNU Data Request 9.8

In the Company's original response to ICNU 9.8, the Company provided the responsive data it had available and indicated that it was incomplete because: (1) it did not reflect the allocation of FERC 707 expenses; and (2) it did not reflect the final allocation of other accounts.

FERC 707 is by far the largest account for labor costs. The numbers provided in the original response reflected FERC 707 costs as allocated to "other" instead of system. The effect of this was to reflect the FERC 707 costs in total expense (i.e. include it in the denominator), but incorrectly assign none of the expense to Oregon (i.e. exclude it from the numerator). The result produced allocation ratios of 19.90% and 18.86% in 2007 and 2008, respectively. The allocation percentages in 2004-2006, before the Company used FERC account 707, ranged from 28.41% to 28.96%.

The Company began using FERC account 707 in 2007 as a temporary labor clearing account. Each month the labor expenses associated with the Company's power delivery employees (distribution and transmission functions) are temporarily charged to this account. Through the Company's labor allocation activity process (secondary labor settlements), the amounts charged to FERC account 707 are credited with the offsetting debit booked to the appropriate FERC accounts with correct revised protocol factors based on the type of work identified. As shown on the "2008" tab, lines 953 and 954 of the original Attachment ICNU 9.8, FERC account 707 includes significant balances which are not allocated to any state. These balances represent the labor expenses associated with the Company's power delivery employees and will remain in FERC account 707 until the labor allocation activity is processed within the Company's accounting system (SAP). Once the labor allocation activity is processed, FERC account 707 is left with zero balance.

A high-level approximation of the total Oregon allocation share of FERC 707 costs can be determined by allocating the balances included in that account by the System Net Plant Distribution (SNPD) factor. Attachment ICNU 9.8 – 2nd

UE-210/PacifiCorp
August 14, 2009
ICNU 9th Set Data Request 9.8 – 2nd Supplemental

Supplemental provides this data. The table below shows the approximate Oregon allocation when FERC 707 is allocated in this manner. Please note that accurate state allocation percentages can only be determined after the labor allocation activity is processed for each of the years shown in the attachment. This processing ensures that labor expenses are booked to the appropriate FERC accounts with correct revised protocol allocation factors.

Year	*Approximate Oregon Allocation %
2004	29.0%
2005	28.5%
2006	28.4%
2007	28.4%
2008	28.2%

**These percentages are approximations only based on data extracted from SAP before labor allocation activity processing. The labor allocation activity must be processed to determine the final FERC account and allocator. The labor allocation activity settlement process includes wages, salaries, benefits, etc. and cannot be run for wages and salaries only.*

The Company's CY 2010 projection of Oregon-allocated labor and benefit expenses as filed in Exhibit PPL/702 is based on actual data for the 12-month period ending June 2008, including all labor allocation activity processing. These percentages are shown in the table below.

Year	*Actual Oregon Allocation %'s After Labor Allocation Activity is Processed	
12 ME June 2008	29.5%	Actual
CY 2010 Forecast (PPL/702)	29.5%	Projected based on June 08 Actuals

** These percentages are determined after all labor allocation activity is processed for all components of labor (wages, benefits, pensions, etc.)*

Please refer to non-confidential Attachment ICNU 9.8 – 2nd Supplemental on the enclosed CD.

UE-210/PacifiCorp
July 2, 2009
ICNU 9th Set Data Request 9.33

ICNU Data Request 9.33

Provide the following information for Pacific Power Oregon by month for January through May 2009:

a. Total wages and salaries
b. Total wages and salaries charged to accounts 500 through 932
c. Total wages and salaries charged to capital or other balance sheet accounts
d. Total regular wages and salaries
e. Total overtime wages and salaries.

Response to ICNU Data Request 9.33

Please refer to Attachment ICNU 9.33. PacifiCorp uses FERC 707 as a labor clearing account. The total salary and wages are booked to FERC 707 and allocated out to the various other FERC accounts using labor allocations from time entry. The response provided shows only the total wages and salaries booked and excludes all labor allocation activity since this is considered secondary labor. FERC 707 has a zero balance on a consolidated basis.

Please refer to non-confidential Attachment ICNU 9.33 on the enclosed CD.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 210

In the Matter of	)
	)
PACIFIC POWER & LIGHT	)
(dba PACIFICORP)	)
	)
Request for a General Rate Revision	)

RESPONSE TESTIMONY IN OPPOSITION TO THE STIPULATION

OF MICHAEL B. EARLY

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

October 21, 2009

I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.

A. My name is Michael B. Early and I am the Executive Director of Industrial Customers of Northwest Utilities ("ICNU"). My business address is 333 S.W. Taylor Street, Suite 400, Portland, Oregon, 97204.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND.

A. I received a B.S. from the University of Illinois in 1973, an M.A. from Harvard University in 1975, and a J.D. from Northwestern University in 1978.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.

A. Early in my professional career I represented investor-owned utilities before the Federal Energy Regulatory Commission on electric rate matters. Since 1984, I have represented industrial customers in the Northwest on electric supply, transmission, and rate matters. I became the Executive Director of ICNU in September 2005.

Q. PLEASE DESCRIBE ICNU.

A. ICNU is an incorporated, non-profit association of large industrial electric customers in the Pacific Northwest, with offices in Portland, Oregon. ICNU's PacifiCorp members include companies in the pulp and paper, metal manufacturing, high technology and food processing industries. These industries have been hit very hard by the current economic recession. Although I am not familiar with all of the details, I am aware that many of ICNU's members have taken dramatic and significant efforts keep their facilities operational during the difficult economic conditions, including the consolidation of operations and lowering their operational costs. The rate increase proposed in the Revenue Requirement Settlement Stipulation ("Settlement") will result in additional competitive pressure for our members with facilities in PacifiCorp's Oregon service territory. Many of these facilities are already taking difficult steps to reduce costs. The possible closure or reduced operations of these facilities could have devastating impacts on their local communities, many of which have unemployment rates above Oregon's average unemployment rate, which is already the fifth worst in the nation.

Q. ARE ELECTRICITY COSTS IMPORTANT FOR ICNU'S MEMBERS?

A. Yes. Electricity costs are major cost drivers for many of ICNU's members. While the ongoing recession has caused the product markets for many ICNU members to face deflationary pressures, PacifiCorp continues to relentlessly push for higher rates. Since January 1, 2007, large general service customers have had their PacifiCorp electric rates change more than a dozen times and increase every year (about a 6.8% increase in 2007, a 5.5% increase in 2008, and a 6.8% increase in 2009). These increases are larger than the inflation rate in each of these years. PacifiCorp is seeking about a 6% rate increase in early 2010, despite the fact that its power costs have declined, and is simultaneously proposing significantly lower avoided costs, while its end users have reduced their loads and lowered their own costs.

Q. DOES ICNU SUPPORT THE REVENUE REQUIREMENT SETTLEMENT STIPULATION?

A. No. ICNU strongly opposes the Settlement and recommends that the Oregon Public Utility Commission ("OPUC" or the "Commission") reject it. Now is the wrong time to increase PacifiCorp's rates, especially when the Company has failed to demonstrate the reasonableness of its proposal. In particular, there is no reason to increase PacifiCorp's return on equity in the current economy.

In the alternative to rejecting the Settlement, ICNU recommends that the Commission conditionally approve the Settlement based on further revenue requirement reductions and the adoption of other non-revenue requirement changes. Specifically, the Commission should adopt Michael Gorman's recommendations regarding cost of capital, which reduce PacifiCorp's rate increase request by about $5.5 million, and Ellen Blumenthal's recommendation regarding wages and salaries, which reduce PacifiCorp's rate increase request by $21.7 million, and remove all costs not presently used and useful to Oregon ratepayers.

II. REVENUE REQUIREMENT SETTLEMENT

Q. PLEASE SUMMARIZE THE SETTLEMENT.

A. The Settlement proposes a $45.9 million overall rate increase, which is about 5.4% rate increase for large general service and partial requirements customers. In addition, the large general service and partial requirements customers will likely experience an approximately 0.6% rate increase related to PacifiCorp's transition adjustment mechanism proceeding. Thus, if the Commission approves the Settlement, industrial customers are likely to experience a 6.0% rate increase during the worst economic recession this country has faced since the Great Depression. This is after three years of rate increases, and at the same time that many of PacifiCorp's costs should be declining.

Q. IS PACIFICORP REQUESTING TO INCREASE RATES MORE THAN 6% IN 2010?

A. Yes. PacifiCorp is also requesting that it be allowed in increase rates an additional $45 million. PacifiCorp claims that it paid more in 2008 than $38 million in taxes beyond the amount collected in rates. With interest, PacifiCorp estimates that this will be about a 2.7% rate increase. Although ICNU does not support the Commission's methodology regarding how the utilities should comply with Senate Bill 408, PacifiCorp's SB 408 filing can only be construed as showing that the Company overearned in calendar year 2008. In other words, the Company claims that it earned more taxable income than it expected when rates were set, which means that its earnings exceeded expectations (or the amounts assumed in rates). This is further evidence that the Commission should not allow PacifiCorp to increase rates in this proceeding.

Q. THE SETTLEMENT DESCRIBES THE BASE REVENUE REQUIREMENT INCREASE AS A $41.5 MILLION RATE INCREASE. PLEASE EXPLAIN WHY THAT IS DIFFERENT FROM THE $45.9 MILLION RATE INCREASE YOU DESCRIBED ABOVE.

A. As part of the Settlement, the settling parties agreed to allow PacifiCorp to recover about $4.4 million through separate tariff riders and not "base" rates. The separate tariff riders expire between January 31, 2011 and December 31, 2012. ICNU does not oppose the recovery of these costs in separate tariffs as opposed to "base" rates; however, it would be highly inaccurate to characterize the Settlement's proposed rate increase as $41.5 million. Once all the proposed tariffs riders are included, the Settlement proposes to increase overall rates by $45.9 million.

Q. DOES THE SETTLEMENT EXPLAIN HOW THE PARTIES REACHED THEIR $45.9 MILLION RATE INCREASE?

A. Only in part. The Settlement starts with PacifiCorp's $92.1 million rate increase and then identified five broad areas in which the settling parties agreed to adjustments to reach the overall rate increase. These five areas are: 1) rate of return; 2) administrative and general ("A&G") adjustments; 3) distribution operations and maintenance ("O&M") adjustments; 4) transmission O&M adjustments and property taxes; and 5) miscellaneous rate base adjustments. Each of these categories includes a broad description of the types of adjustments that are included. Except for the overall rate of return, it is impossible to ascertain whether the adjustments accept or reject specific adjustments proposed by Staff or intervenors. This is a classic "black box" settlement which I believe is particularly inappropriate in these economic times. Every component of a rate increase should be specifically justified.

ICNU attempted to determine whether the overall adjustments included specific adjustments proposed by Staff or ICNU. The data responses that we obtained from PacifiCorp and Staff stated that the requested information was not available and that broad level information in the Settlement provides the information at the greatest level of detail possible. ICNU/701, Early/4-15, 19-30. ICNU specifically sought information on how each of Staff's and ICNU's adjustments were accounted for in the Settlement, and neither Staff nor PacifiCorp could provide any detail. Id. Therefore, this "black box" Settlement does not provide any specificity justifying this significant rate increase.

Q. CAN YOU PROVIDE A SPECIFIC EXAMPLE?

A. Yes. Staff recommended a number of miscellaneous rate base adjustments primarily related to costs that are not known and measurable, including costs that are scheduled to be incurred after rates go into effect on February 2, 2010. Staff/100, Garcia/6-7. Staff's opening testimony described this as Staff adjustment "S-8" and estimated the total Oregon revenue requirement impact of the S-8 miscellaneous rate base adjustments as $13.725 million. Id.; Staff/102, Garcia/2. Staff contested some of PacifiCorp's forecasted costs because there was no guarantee that the costs were accurate, would be completed by the forecast date, or be completed at all. Staff/100, Garcia/7-8. Staff testified that PacifiCorp's "guesstimates" were not appropriate and that these costs should be removed. Id. at Garcia/8. Staff's recommendation was based in part on the Oregon statute which prohibits the addition to rate base of costs "not presently used for providing utility service to the customer." Id. at Garcia/7 citing ORS § 757.355.

Q. DOES THE SETTLEMENT REMOVE ALL THE COSTS WHICH ARE NOT PRESENTLY USED AND USEFUL FOR OREGON RATEPAYERS?

A. No, it does not. In discovery, ICNU sought to determine if these costs (which are not presently used and useful to customers) would be included in rates. Neither PacifiCorp nor Staff answered ICNU's questions. ICNU/701, Early/4, 14-15, 20, 29-30.

A review of the Settlement itself, however, demonstrates that these illegal costs have not been fully removed from PacifiCorp's rate increase request. The Settlement agrees to "miscellaneous rate base adjustments" that reduces PacifiCorp's rate increase request by $8.9 million. Settlement, Exhibit A. This settled a number of Staff rate base adjustments (Staff adjustments S-3, S-7, S-8, S-10 and S-11) which totaled $19.165 million in Staff's opening testimony. Id.; Staff/102, Garcia/1-2. All of the costs associated with the Staff adjustment "S-8" have not been removed from rates because the original Staff adjustment "S-8" has a larger revenue requirement impact ($13.725 million) than the totaled settled amount for five different Staff issues, including "S-8" ($8.9 million). The Commission should reject the Settlement since the settling parties have not demonstrated that these illegal costs have been completely removed from rates.

Q. HAVE YOU CALCULATED THE CURRENT VALUE OF S-8, THE MISCELLANEOUS RATE BASE ADJUSTMENT?

A. No; however, ICNU witness Ellen Blumenthal has calculated the value of S-8 based on Mr. Gorman's proposed capital structure. She calculates the total amount of this adjustment as $14.4 million.

Q. DO YOU BELIEVE THIS TYPE OF "BLACK BOX" SETTLEMENT IS APPROPRIATE?

A. No. I believe that "black box" settlements are only appropriate when all major parties testifying regarding the disputed issues are in agreement. ICNU disfavors "black box" settlements in general; however, "black box" settlements can be appropriate when all parties agree on the overall revenue requirement amount, but cannot agree on the specific methodologies to reach the overall revenue requirement amount. The Commission and the parties opposed to the "black box" settlement are placed in an untenable position of only having an overall revenue requirement number, but no real idea how the number was obtained. It is difficult to determine how such "black box" settlements address the specific remaining concerns of non-settling parties. It is also difficult to see how any individual rate categories result in fair, just and reasonable rates.

For example, the testimony in support of the settlement states that Ms. Blumenthal's wage and salaries adjustments are "largely subsumed in the A&G adjustment . . . ." Joint-Revenue Requirement/100, Garcia, et al./7. Despite this claim, Staff and PacifiCorp could not (or refused to) answer a number of questions regarding whether the Settlement adjustments were duplicative of Ms. Blumenthal's adjustments, or what portion or how much of Ms. Blumenthal's adjustments were accounted for in the Settlement. Id. at Early/4-7, 18-38. The settlement parties can claim that they considered ICNU's proposals, but there is no way to verify or quantify those claims because the settlement is largely a "black box." If the settling parties had agreed to transparent settlement that specifically identified the adjustments, then the Commission would have a more complete record to review and evaluate the reasonableness of the Settlement and whether it actually addressed the issues raised by non-settling parties.

III. ICNU RECOMMENDATIONS

Q. WHAT IS YOUR RECOMMENDATION?

A. I recommend that the Commission reject the Settlement. If the settling parties believe that a $45.9 million rate increase is appropriate, then they should be required to identify the specific revenue requirement adjustments to allow the Commission to review whether the overall rates and their individual components are legal, fair, just and reasonable.

Q. IF THE COMMISSION DOES NOT REJECT THE SETTLEMENT, WHAT ACTION DO YOU RECOMMEND THAT THE COMMISSION TAKE?

A. Alternatively, I recommend that the Commission approve the Settlement subject to a number of conditions. The Commission should allow Staff, PacifiCorp and the other parties to resolve their disputed issues, but then adopt ICNU's recommendations on the remaining contested issues.

First, the Commission should recognize that the Settlement does not make any specific adjustments for Ms. Blumenthal's wage and salaries adjustment. The Commission should reduce the $45.9 million increase by $21.7 million to account for her recommendations on wages and salaries. PacifiCorp should be cutting costs instead of increasing its non-union wages and salaries in the current recession.

Second, the Commission should adopt Mr. Gorman's recommendation regarding cost of capital, and reduce the revenue requirement increase request by about $5.5 million. Although I am not a cost of capital expert, Mr. Gorman's recommendation is reasonable and represents sound public policy. As I understand it, Mr. Gorman is essentially recommending that the Commission maintain the status quo regarding return on equity and not increase PacifiCorp's return on equity. It would be highly inappropriate for the Commission to increase PacifiCorp's return on equity during these difficult economic conditions. The overall reasonableness of Mr. Gorman's position is confirmed by the fact that Staff's testimony recommended an even lower rate of return and return on equity. Thus, Mr. Gorman's middle of the road recommendation is within the zone of reasonable recommendations presented to the Commission.

The reasonableness of Mr. Gorman's recommendation is also highlighted by statements by PacifiCorp's ultimate owner, Warren Buffett. Mr. Buffett has stated that people should not expect to earn 10% or more from equities. ICNU/702, Early/18. The Settlement's rate of return includes an increase in PacifiCorp's return on equity from 10% to 10.125%. In February 2008, Mr. Buffet said "that people who expect to earn 10% annually from equities during this century . . . are apparently direct descendants of the queen in Alice in Wonderland, who said: 'Why, sometimes I've believed as many as six impossible things before breakfast.'" Id. Mr. Buffett's comments are even more relevant after the economic changes which have occurred over the past year. Further, the recent PacifiCorp tax report seems to indicate that the Company was overearning at the same time that it was seeking to raise rates.

Third, I recommend that the Commission remove all of the miscellaneous rate base in Staff adjustment "S-8" for rate base items not used and useful for Oregon ratepayers, as identified by Ms. Garcia's opening testimony.

Q. DO YOU HAVE ANY OTHER RECOMMENDED CONDITIONS THAT THE COMMISSION SHOULD IMPOSE UPON THE SETTLEMENT?

A. Yes. The Commission should require PacifiCorp to place the gain on any sales of any Oregon allocated renewable energy credits ("RECs") into a balancing account for refund to customers with interest. Staff made such a recommendation in its testimony. Staff/300, Doughterty/8-9. ICNU supports this recommendation, and is concerned that the Company may retain any gains associated with the sale of RECs, if any such sales are made.

The Settlement does not include any provisions which would require that PacifiCorp place the gain from the sales of RECs in a balancing account nor does the Settlement even require PacifiCorp to report in its semi-annual property sales balancing account any REC sales. ICNU/701, Early/16-17, 36-37. PacifiCorp claims that such requirements are "unnecessary" because the Company is not currently planning on selling any Oregon-allocated RECs. Id. at Early/36.

I do not find PacifiCorp's response compelling or persuasive. If the Company is not actually planning to sell any RECs, then it should not be burdensome for PacifiCorp to agree to report any sales and to place them in a balancing account. In addition, I would note that the parties to PacifiCorp's most recently completed Washington rate case did not simply trust the Company's assertions, but included specific provisions in their settlement that required PacifiCorp provide detailed information regarding its RECs and any sales. WUTC v. PacifiCorp, Docket No. UE-090205, Settlement Stipulation ¶¶ 21-22 (Aug. 25, 2009). These reporting requirements are especially important because PacifiCorp operates in six states and is subject to three different renewable portfolio standards. The Commission should protect the interests of Oregon ratepayers and uphold the integrity of Oregon's renewable portfolio standard by requiring the Company to report any sales and record them in an appropriate balancing account.

IV. CONCLUSION

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes; however, I would like to reiterate the importance of this case to ICNU and its members because of the difficult economic conditions in Oregon. I urge the Commission to carefully review the record and ascertain whether PacifiCorp has met its burden of proof to justify all aspects of its proposed rate increase. ICNU does not believe this rate increase is justified.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated October 2, 2009 – Due October 6, 2009
Data Request No. 2.1

Provide copies of Data Requests 2.1 – 2.2 to Michael Gorman.

Request:

2.1 Please refer to Table 1 of the Joint-Revenue Requirement/100, Garcia et al./5. Please provide PacifiCorp's current authorized capital components, percent capitalization, cost and weighted cost for each item identified on Table 1.

Response:

Please refer to pages 4 and 5 of Order No. 06-530 in Docket UE 179 at http://apps.puc.state.or.us/orders/2006ords/06-530.pdf . The authorized capital components, percent capitalization, cost and weighted cost, as documented in Order No. 06-530, were unchanged in subsequent Order No. 06-564 in the same docket; see page 8 of the Order at http://apps.puc.state.or.us/orders/2006ords/06-564.pdf . Additionally, the labels and values in the cost of capital tables on Page 6 of Appendix A of each Order are identical and identical with those in the cost of capital tables appearing within the body of each Order. Below is a reconstructed table having labels and values identical with each of the four tables referenced above.

Component	% of Capital	Cost	Weighted Cost
Debt	49.00%	6.32%	3.10%
Preferred	1.00%	6.30%	0.06%
Common	50.00%	10.00%	5.00%
Total	100.00%		8.16%

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.2

Request:

Provide copies of Data Requests 2.1 – 2.2 to Michael Gorman.

2.2 Please refer to Table 1 of the Joint-Revenue Requirement/100, Garcia et al./5. Please provide PacifiCorp's current authorized capital components, percent capitalization, cost and weighted cost for each item identified on Table 1.

Response:
Please see response to DR 2.1 – same question.

Oregon Public Utility Commission Staff Response
<u>UE 210 – ICNU's Second Set of Data Requests to OPUC</u>
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.3

<u>Provide copies of Data Requests 2.3 – 2.22 to Ellen Blumenthal.</u>

Request:

2.3 Please refer to Exhibit A, S-0 Rate of Return adjustment. Please provide the Oregon revenue requirement impact based on PacifiCorp's current authorized capital components, percent capitalization, and cost and weighted cost.

Response:

Staff calculated its numbers based upon the numbers provided in the stipulation. Staff has not run the revenue requirement impact based upon INCU's request.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.4

Request:

2.4 Please refer to Exhibit A, the revenue requirement effect for items S-4, S-2, S-9 and ICNU/CUB Adj. Please identify the specific settlement adjustment for: 1) 401k expense; 2) insurance expense; 3) workers compensation expense; 4) challenge grants; 5) FAS 112 expense; 6) Staff uncollectables; 7) Staff incentives; 8) Staff insurance; 9) ICNU/CUB incentives, benefits and pensions; and 10) ICNU/CUB wages.

Response:

The Parties considered the categories of costs as outlined in the Stipulation in determining that the settlement was fair, just, and reasonable. While Staff considered all of the adjustments and positions of the parties in determining the reasonableness of the aggregated numbers in the Stipulation, it has not broken down the categories into the individual items requested, but rather considered the reasonableness of the aggregate number based upon its view of the specific proposed adjustments.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.5

Request:

2.5 Based on the most current filed Staff, ICNU/CUB testimony, please identify the filed Staff and/or ICNU/CUB revenue requirement impact of the S-4, S-2, S-9 and ICNU/CUB adjustments for: 1) 401k expense; 2) insurance expense; 3) workers compensation expense; 4) challenge grants; 5) FAS 112 expense; 6) Staff uncollectables; 7) Staff incentives; 8) Staff insurance; 9) ICNU/CUB incentives, benefits and pensions; and 10) ICNU/CUB wages.

Response:

Please refer to Staff's Opening Testimony.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.6

Request:

2.6 Based on Staff's opening testimony, please identify whether any Staff adjustments are duplicative of the adjustment proposed by Ms. Ellen Blumenthal.

Response:

Staff had an adjustment for incentives that was similar to Ms. Ellen Blumenthal's. Please see the Staff testimony of Ms. Gorsuch on the company's bonus and incentive plans.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.7

Request:

2.7 Based on Staff's opening testimony, if any of Staff's adjustments are duplicative, please identify the duplicative adjustment, the portion of Staff's adjustment that is duplicative, the remaining amount of Staff's adjustment, and the remaining amount of Ms. Blumenthal's adjustment.

Response:

See Staff's response to ICNU's data request 2.6.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.8

Request:

2.8 Please refer to Exhibit A, the revenue requirement effect for items S-3, S-7, S-8, S-10, and S-11. Please identify the specific settlement adjustments for: 1) MEHC severance; 2) GridWest; 3) OR transition plan; 4) change in allocation factors; 5) ECD updates; and 6) other rate base adjustments.

Response:

See Staff's response to ICNU's data request 2.4.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.9

Request:

2.9 Based on the most current filed Staff and/or ICNU/CUB testimony, please identify the revenue requirement effect of the S-3, S-7, S-8, S-10, and S-11 for: 1) MEHC severance; 2) GridWest; 3) OR transition plan; 4) change in allocation factors; 5) ECD updates; and 6) other rate base adjustments.

Response:

See Staff's response to ICNU's data request 2.5.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.12

Request:

2.12 Please refer to Staff/200. Based on Staff's filed testimony, please identify the Oregon revenue requirement impact of issues 1 to 13.

Response:

Please see Garcia Exhibit 202 in Staff's Opening Testimony.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.13

Request:

2.13 Please refer to Exhibit A. Please identify the revenue requirement effect for issues 1 to 13 in Staff/200.

Response:

See Staff's response to ICNU's data request 2.4.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.14

Request:

2.14 Based on Staff's filed testimony, please identify the Oregon revenue requirement impact of: 1) S-3; 2) S-8, 3) S-10, and 4) S-11.

Response:

See Staff's response to ICNU's data request 2.12.

Oregon Public Utility Commission Staff Response
<u>UE 210 – ICNU's Second Set of Data Requests to OPUC</u>
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.15

Request:

2.15 Please refer to Exhibit A, the revenue requirement effect for items S-3, S-7, S-8, S-10, and S-11. Please identify the specific revenue requirement adjustments related to: 1) S-3; 2) S-8, 3) S-10, and 4) S-11.

Response:

See Staff's response to ICNU's data request 2.4.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.16

Request:

2.16 Based on Staff's filed testimony, please identify the Oregon revenue requirement impact for: 1) items scheduled to go into service subsequent to rates taking effect; 2) items that do not belong in rate base; and 3) items labeled by PacifiCorp as having monthly or variable in service dates.

Response:

See Staff's response to ICNU's data request 2.4.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.17

Request:

2.17 Please refer to Exhibit A, the miscellaneous rate base adjustment for items S-3, S-7, S-8, S-10, and S-11. Please identify the specific revenue requirement adjustments related to: 1) items scheduled to go into service subsequent to rates taking effect; 2) items that do not belong in rate base; and 3) items labeled by PacifiCorp as having monthly or variable in service dates.

Response:

See Staff's response to ICNU's data request 2.4.

Oregon Public Utility Commission Staff Response
<u>UE 210 – ICNU's Second Set of Data Requests to OPUC</u>
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.20

Request:

2.20 Please identify if the settlement provides that PacifiCorp will place the gain on the sale of any RECs in a balancing account for refund to customers with interest from the date of the sale.

Response:

The Settlement does not state how RECs will be handled.

Oregon Public Utility Commission Staff Response
<u>UE 210 – ICNU's Second Set of Data Requests to OPUC</u>
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.21

Request:

2.21 Please identify if the settlement requires PacifiCorp to report in its semi-annual property sales balancing account any REC sales that occur during the reporting period.

Response:

See Staff's response to ICNU's data request 2.20.

Oregon Public Utility Commission Staff Response
UE 210 – ICNU's Second Set of Data Requests to OPUC
Dated September 28, 2009 – Due October 6, 2009
Data Request No. 2.22

Request:

2.22 Please refer to Joint-Revenue Requirement/100, Garcia et al./10, lines 15-22. Please describe what is meant by Staff "considered Ms. Blumenthal's adjustment in concluding that the stipulated A&G amount was a reasonable resolution of all A&G issues, including Ms. Blumenthal's proposed adjustment to wages and salaries." Please identify whether the Exhibit A "A&G Adjustments" has a larger revenue requirement impact because of this "consideration." Please identify the amount the "A&G Adjustments" would be if Staff had not considered Ms. Blumenthal's wages and salaries adjustment.

Response:

Staff means that it reviewed and analyzed Ms. Blumenthal's adjustment and considered the adjustment in context of agreeing to what it believes is an overall reasonable settlement number for A&G expense. As discussed in Staff data response 2.4, Staff did not break out and assign a number for each possible adjustment, but rather considered the overall level of A&G stipulated expense in context of all the proposed A&G adjustments, which included consideration of Ms. Blumenthal's adjustment. Because the numbers were considered in totality based upon Staff's review and analysis, it does not have a breakout of each category.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.4

ICNU Data Request 16.4

Please refer to Exhibit A, the revenue requirement effect for items S-4, S-2, S-9 and ICNU/CUB Adj. Please identify the specific settlement adjustment for: 1) 401k expense; 2) insurance expense; 3) workers compensation expense; 4) challenge grants; 5) FAS 112 expense; 6) Staff uncollectables; 7) Staff incentives; 8) Staff insurance; 9) ICNU/CUB incentives, benefits and pensions; and 10) ICNU/CUB wages.

Response to ICNU Data Request 16.4

The requested information is not available. Exhibit A provides the revenue requirement impact for the items referenced in this data request at the greatest level of detail agreed upon by the Parties.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.5

ICNU Data Request 16.5

Based on the most current filed Staff, ICNU/CUB testimony, please identify the filed Staff and/or ICNU/CUB revenue requirement impact of the S-4, S-2, S-9 and ICNU/CUB adjustments for: 1) 401k expense; 2) insurance expense; 3) workers compensation expense; 4) challenge grants; 5) FAS 112 expense; 6) Staff uncollectables; 7) Staff incentives; 8) Staff insurance; 9) ICNU/CUB incentives, benefits and pensions; and 10) ICNU/CUB wages.

Response to ICNU Data Request 16.5

Staff's testimony speaks for itself on these issues. To the extent ICNU seeks discovery related to Staff's testimony, it should direct such questions to Staff. ICNU is in the position to analyze its own testimony and adjustments.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.6

ICNU Data Request 16.6

Based on Staff's opening testimony, please identify whether any Staff adjustments are duplicative of the adjustment proposed by Ms. Ellen Blumenthal.

Response to ICNU Data Request 16.6

Please refer to Staff Response to ICNU Data Request 2.6.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.7

ICNU Data Request 16.7

Based on Staff's opening testimony, if any of Staff's adjustments are duplicative, please identify the duplicative adjustment, the portion of Staff's adjustment that is duplicative, the remaining amount of Staff's adjustment, and the remaining amount of Ms. Blumenthal's adjustment.

Response to ICNU Data Request 16.7

Please refer to Staff Response to ICNU Data Request 2.7.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.8

ICNU Data Request 16.8

Please refer to Exhibit A, the revenue requirement effect for items S-3, S-7, S-8, S-10, and S-11. Please identify the specific settlement adjustments for: 1) MEHC severance; 2) GridWest; 3) OR transition plan; 4) change in allocation factors; 5) ECD updates; and 6) other rate base adjustments.

Response to ICNU Data Request 16.8

Please refer to Response to ICNU Data Request 16.4.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.9

ICNU Data Request 16.9

Based on the most current filed Staff and/or ICNU/CUB testimony, please identify the revenue requirement effect of the S-3, S-7, S-8, S-10, and S-11 for: 1) MEHC severance; 2) GridWest; 3) OR transition plan; 4) change in allocation factors; 5) ECD updates; and 6) other rate base adjustments.

Response to ICNU Data Request 16.9

Please refer to Response to ICNU Data Request 16.5.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.12

ICNU Data Request 16.12

Please refer to Staff/200. Based on Staff's filed testimony, please identify the Oregon revenue requirement impact of issues 1 to 13.

Response to ICNU Data Request 16.12

Please refer to Response to ICNU Data Request 16.5.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.13

ICNU Data Request 16.13

Please refer to Exhibit A. Please identify the revenue requirement effect for issues 1 to 13 in Staff/200.

Response to ICNU Data Request 16.13

Please refer to Response to ICNU Data Request 16.4.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.14

ICNU Data Request 16.14

Based on Staff's filed testimony, please identify the Oregon revenue requirement impact of: 1) S-3; 2) S-8; 3) S-10; and 4) S-11.

Response to ICNU Data Request 16.14

Please refer to Response to ICNU Data Request 16.5.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.15

ICNU Data Request 16.15

Please refer to Exhibit A, the revenue requirement effect for items S-3, S-7, S-8, S-10, and S-11. Please identify the specific revenue requirement adjustments related to: 1) S-3; 2) S-8; 3) S-10; and 4) S-11.

Response to ICNU Data Request 16.15

Please refer to Response to ICNU Data Request 16.4.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.16

ICNU Data Request 16.16

Based on Staff's filed testimony, please identify the Oregon revenue requirement impact for: 1) items scheduled to go into service subsequent to rates taking effect; 2) items that do not belong in rate base; and 3) items labeled by PacifiCorp as having monthly or variable in service dates.

Response to ICNU Data Request 16.16

Please refer to Response to ICNU Data Request 16.5 and Deborah Garcia's opening testimony.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.17

ICNU Data Request 16.17

Please refer to Exhibit A, the miscellaneous rate base adjustment for items S-3, S-7, S-8, S-10, and S-11. Please identify the specific revenue requirement adjustments related to: 1) items scheduled to go into service subsequent to rates taking effect; 2) items that do not belong in rate base; and 3) items labeled by PacifiCorp as having monthly or variable in service dates.

Response to ICNU Data Request 16.17

Please refer to Response to ICNU Data Request 16.4.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.18

ICNU Data Request 16.18

Please provide PacifiCorp's estimates regarding the number of Oregon allocated renewable energy credits ("RECs") for the years 2011 through 2025.

Response to ICNU Data Request 16.18

Please refer to Attachment ICNU 16.18, which is based on PacifiCorp's 2008 IRP, using eligible resources from existing and preferred portfolio resources and assumes Oregon's projected allocated share of resources and transfer of renewable energy credits between states. The compliance position is subject to change as load forecasts are updated, current or future IRPs are updated, future IRPs are published, other renewable resources become eligible (e.g., low impact hydro, incremental hydro upgrades, etc.) and/or future state legislation is enacted, future federal legislation is enacted and/or the Commission enacts applicable rules.

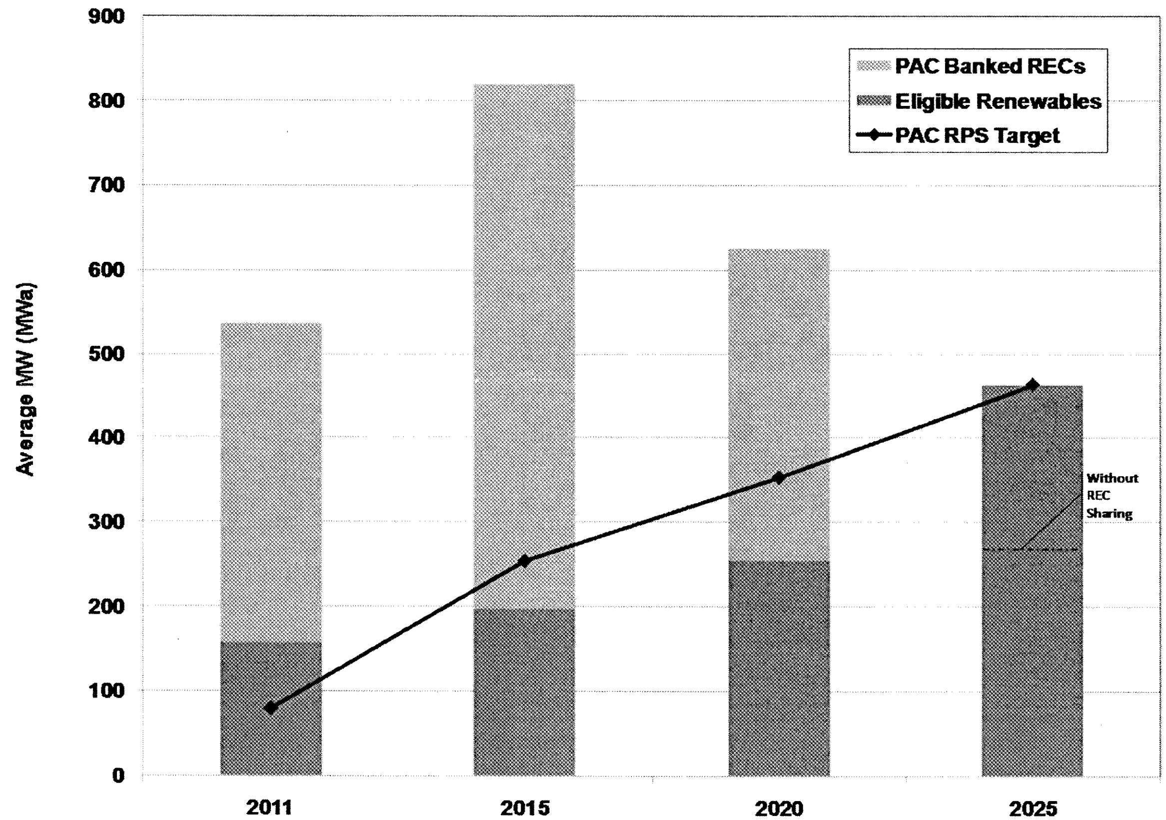
Please refer to non-confidential Attachment ICNU 16.18 provided in hard copy.

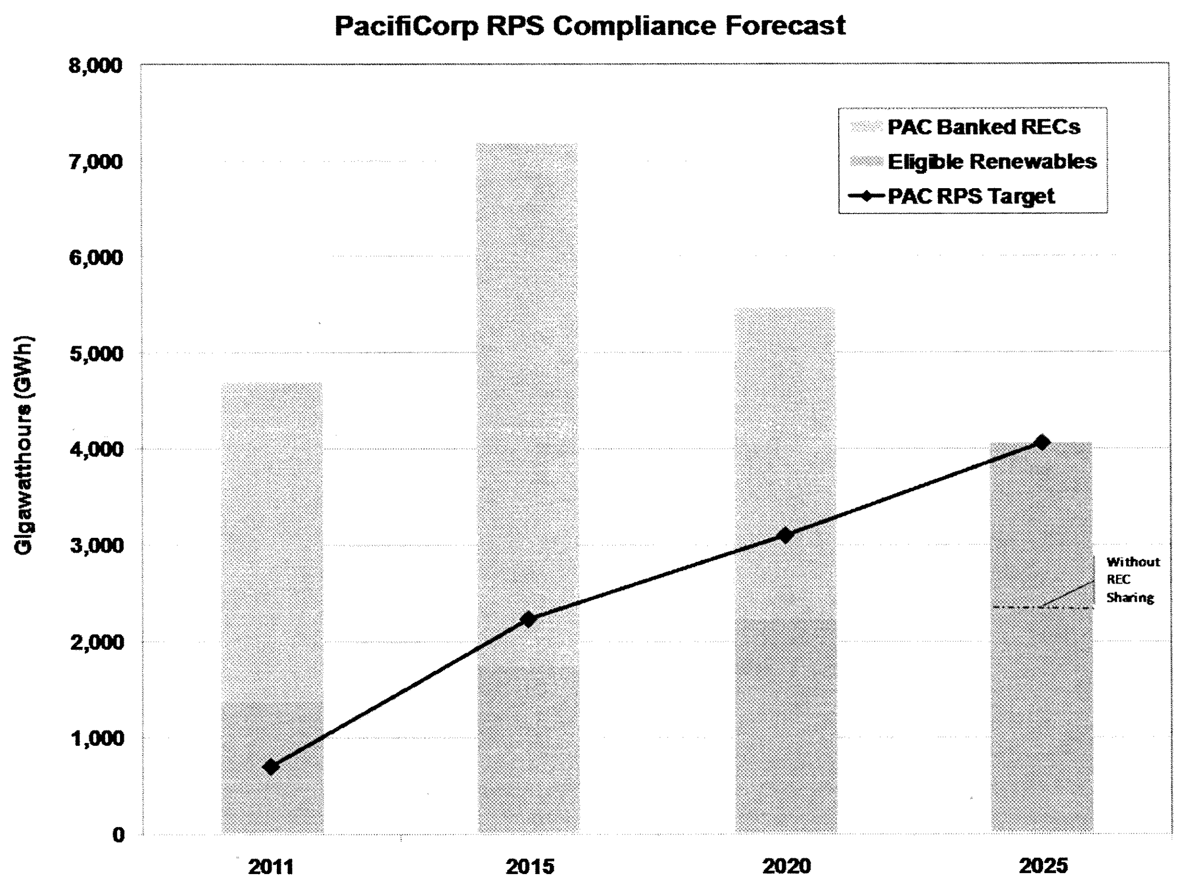
Assumed Oregon Eligible Renewable Resources

Fuel	Resource	State	Capacity (MW)	COD	Status/Comment	Type
Geothermal	Blundell II	UT	11	2007	Operational	Utility Owned
Wind	Rock River I	WY	50	2001	Operational	PPA
Wind	Foote Creek	WY	32.6	1999	Operational	Utility Owned
Wind	Combine Hills	OR	41	2003	Operational	PPA
Wind	Leaning Juniper 1	OR	100.5	2006	Operational	Utility Owned
Wind	Wolverine Creek	ID	64.5	2005	Operational	PPA
Wind	Marengo	WA	140.4	2007	Operational	Utility Owned
Wind	Marengo II	WA	70.2	2008	Operational	Utility Owned
Wind	Goodnoe Hills	WA	94	2008	Operational	Utility Owned
Wind	Mountain Wind 1	WY	60	2008	Operational	QF PPA
Wind	Mountain Wind 2	WY	79.5	2008	Operational	QF PPA
Wind	Glenrock	WY	99	2008	Operational	Utility Owned
Wind	Seven Mile Hill	WY	99	2008	Operational	Utility Owned
Wind	Seven Mile Hill II	WY	19.5	2008	Operational	Utility Owned
Wind	Glenrock III	WY	39	2009	Operational	Utility Owned
Wind	High Plains	WY	99	2009	Operational	Utility Owned
Wind	Duke Energy PPA (Three Buttes)	WY	99	2010	Under development	PPA
Geothermal	Blundell III	UT	35	2013	IRP Planning Assumption	N/A
Wind	IRP Wind East 2010 (150 MW)	WY	150	2010	IRP Planning Assumption	N/A
Wind	IRP Wind East 2012 (100 MW)	WY	100	2012	IRP Planning Assumption	N/A
Wind	IRP Wind East 2013 (100 MW)	WY	100	2013	IRP Planning Assumption	N/A
Wind	IRP Wind East 2014 (100 MW)	WY	100	2014	IRP Planning Assumption	N/A
Wind	IRP Wind East 2015 (150 MW)	WY	150	2015	IRP Planning Assumption	N/A
Wind	IRP Wind East 2016 (100 MW)	WY	100	2016	IRP Planning Assumption	N/A
Wind	IRP Wind East 2017 (100 MW)	WY	100	2017	IRP Planning Assumption	N/A
Wind	IRP Wind East 2018 (50 MW)	WY	50	2018	IRP Planning Assumption	N/A
Wind	IRP Wind East 2019 (200 MW)	WY	200	2019	IRP Planning Assumption	N/A
Wind	IRP Wind East 2020 (200 MW)	WY	200	2020	IRP Planning Assumption	N/A
Wind	IRP Wind East 2021 (150 MW)	WY	150	2021	IRP Planning Assumption	N/A
Wind	IRP Wind West 2011 (Yakima)	WA	100	2011	IRP Planning Assumption	N/A
Wind	IRP Wind West 2011 (Walla Walla)	WA	100	2011	IRP Planning Assumption	N/A

Source: PacifiCorp 2008 IRP

PacifiCorp RPS Compliance Forecast




PacifiCorp RPS Compliance Forecast
Gigawatthours (GWh)
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
0
2011
2015
2020
2025
PAC Banked RECs
Eligible Renewables
PAC RPS Target
Without REC Sharing

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.19

ICNU Data Request 16.19

Please confirm that PacifiCorp estimates that it will have sufficient RECs allocated to Oregon to meet RPS requirements for the years 2011 through 2016.

Response to ICNU Data Request 16.19

Confirmed. Please refer to Attachment ICNU 16.18.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.20

ICNU Data Request 16.20

Please identify if the settlement provides that PacifiCorp will place the gain on the sale of any RECs in a balancing account for refund to customers with interest from the date of the sale.

Response to ICNU Data Request 16.20

No. Such action is unnecessary because PacifiCorp is not planning to sell any Oregon-allocated eligible RECs in the future due to its need to bank the RECs for future compliance with the Oregon RPS.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.21

ICNU Data Request 16.21

Please identify if the settlement requires PacifiCorp to report in its semi-annual property sales balancing account any REC sales that occur during the reporting period.

Response to ICNU Data Request 16.21

Please refer to Response to ICNU Data Request 16.20.

UE-210/PacifiCorp
October 7, 2009
ICNU 16th Set Data Request 16.22

ICNU Data Request 16.22

Please refer to Joint-Revenue Requirement/100, Garcia et al./10, lines 15-22. Please describe what is meant by Staff "considered Ms. Blumenthal's adjustment in concluding that the stipulated A&G amount was a reasonable resolution of all A&G issues, including Ms. Blumenthal's proposed adjustment to wages and salaries." Please identify whether the Exhibit A "A&G Adjustments" has a larger revenue requirement impact because of this "consideration." Please identify the amount the "A&G Adjustments" would be if Staff had not considered Ms. Blumenthal's wages and salaries adjustment.

Response to ICNU Data Request 16.22

Please refer to Staff Response to ICNU Data Request 2.22.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 210

In the Matter of	)
	)
PACIFICORP, dba PACIFIC POWER	)
	)
Request for a General Rate Revision	)
	)
	)

ICNU/702

WARREN BUFFET ADDRESS TO
SHAREHOLDERS OF BERKSHIRE HATHAWAY
(FEBRUARY 2008)

October 21, 2009

Note: The following table appears in the printed Annual Report on the facing page of the Chairman's Letter and is referred to in that letter.

Berkshire's Corporate Performance vs. the S&P 500

	Annual Percentage Change		
Year	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
1999	.5	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
Compounded Annual Gain – 1965-2007	21.1%	10.3%	10.8
Overall Gain – 1964-2007	400,863%	6,840%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 2007 was $12.3 billion, which increased the per-share book value of both our Class A and Class B stock by 11%. Over the last 43 years (that is, since present management took over) book value has grown from $19 to $78,008, a rate of 21.1% compounded annually.*

Overall, our 76 operating businesses did well last year. The few that had problems were primarily those linked to housing, among them our brick, carpet and real estate brokerage operations. Their setbacks are minor and temporary. Our competitive position in these businesses remains strong, and we have first-class CEOs who run them right, in good times or bad.

Some major financial institutions have, however, experienced staggering problems because they engaged in the "weakened lending practices" I described in last year's letter. John Stumpf, CEO of Wells Fargo, aptly dissected the recent behavior of many lenders: "It is interesting that the industry has invented new ways to lose money when the old ways seemed to work just fine."

You may recall a 2003 Silicon Valley bumper sticker that implored, "Please, God, Just One More Bubble." Unfortunately, this wish was promptly granted, as just about all Americans came to believe that house prices would forever rise. That conviction made a borrower's income and cash equity seem unimportant to lenders, who shoveled out money, confident that HPA – house price appreciation – would cure all problems. Today, our country is experiencing widespread pain because of that erroneous belief. As house prices fall, a huge amount of financial folly is being exposed. You only learn who has been swimming naked when the tide goes out – and what we are witnessing at some of our largest financial institutions is an ugly sight.

Turning to happier thoughts, we can report that Berkshire's newest acquisitions of size, TTI and Iscar, led by their CEOs, Paul Andrews and Jacob Harpaz respectively, performed magnificently in 2007. Iscar is as impressive a manufacturing operation as I've seen, a view I reported last year and that was confirmed by a visit I made in the fall to its extraordinary plant in Korea.

Finally, our insurance business – the cornerstone of Berkshire – had an excellent year. Part of the reason is that we have the best collection of insurance managers in the business – more about them later. But we also were very lucky in 2007, the second year in a row free of major insured catastrophes.

That party is over. It's a *certainty* that insurance-industry profit margins, including ours, will fall significantly in 2008. Prices are down, and exposures inexorably rise. Even if the U.S. has its third consecutive catastrophe-light year, industry profit margins will probably shrink by four percentage points or so. If the winds roar or the earth trembles, results could be *far* worse. So be prepared for lower insurance earnings during the next few years.

Yardsticks

Berkshire has two major areas of value. The first is our investments: stocks, bonds and cash equivalents. At yearend these totaled $141 billion (not counting those in our finance or utility operations, which we assign to our second bucket of value).

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*All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/30th of those shown for the A.

Insurance float – money we temporarily hold in our insurance operations that does not belong to us – funds \$59 billion of our investments. This float is "free" as long as insurance underwriting breaks even, meaning that the premiums we receive equal the losses and expenses we incur. Of course, insurance underwriting is volatile, swinging erratically between profits and losses. Over our entire history, however, we've been profitable, and I expect we will average breakeven results or better in the future. If we do that, our investments can be viewed as an unencumbered source of value for Berkshire shareholders.

Berkshire's second component of value is earnings that come from sources other than investments and insurance. These earnings are delivered by our 66 non-insurance companies, itemized on page 76. In our early years, we focused on the investment side. During the past two decades, however, we have put ever more emphasis on the development of earnings from non-insurance businesses.

The following tables illustrate this shift. In the first we tabulate per-share investments at 14-year intervals. We exclude those applicable to minority interests.

Year	*Per-Share Investments*	*Years*	*Compounded Annual Gain in Per-Share Investments*
1965	\$ 4		
1979	577	1965-1979	42.8%
1993	13,961	1979-1993	25.6%
2007	90,343	1993-2007	14.3%

For the entire 42 years, our compounded annual gain in per-share investments was 27.1%. But the trend has been downward as we increasingly used our available funds to buy operating businesses.

Here's the record on how earnings of our non-insurance businesses have grown, again on a per-share basis and after applicable minority interests.

Year	*Per Share Pre-Tax Earnings*	*Years*	*Compounded Annual Gain in Per-Share Pre-Tax Earnings*
1965	\$ 4		
1979	18	1965-1979	11.1%
1993	212	1979-1993	19.1%
2007	4,093	1993-2007	23.5%

For the entire period, the compounded annual gain was 17.8%, with gains accelerating as our focus shifted.

Though these tables may help you gain historical perspective and be useful in valuation, they are completely misleading in predicting future possibilities. *Berkshire's past record can't be duplicated or even approached. Our base of assets and earnings is now far too large for us to make outsized gains in the future.*

Charlie Munger, my partner at Berkshire, and I will continue to measure our progress by the two yardsticks I have just described and will regularly update you on the results. Though we can't come close to duplicating the past, we will do our best to make sure the future is not disappointing.

* * * * * * * * * * * *

In our efforts, we will be aided enormously by the managers who have joined Berkshire. This is an unusual group in several ways. First, most of them have no financial need to work. Many sold us their businesses for large sums and run them because they love doing so, not because they need the money. Naturally they wish to be paid fairly, but money alone is not the reason they work hard and productively.

A second, somewhat related, point about these managers is that they have exactly the job they want for the rest of their working years. At almost any other company, key managers below the top aspire to keep climbing the pyramid. For them, the subsidiary or division they manage today is a way station – or so they hope. Indeed, if they are in their present positions five years from now, they may well feel like failures.

Conversely, our CEOs' scorecards for success are not whether they obtain my job but instead are the long-term performances of their businesses. Their decisions flow from a here-today, here-forever mindset. I think our rare and hard-to-replicate managerial structure gives Berkshire a real advantage.

Acquisitions

Though our managers may be the best, we will need large and sensible acquisitions to get the growth in operating earnings we wish. Here, we made little progress in 2007 until very late in the year. Then, on Christmas day, Charlie and I finally earned our paychecks by contracting for the largest cash purchase in Berkshire's history.

The seeds of this transaction were planted in 1954. That fall, only three months into a new job, I was sent by my employers, Ben Graham and Jerry Newman, to a shareholders' meeting of Rockwood Chocolate in Brooklyn. A young fellow had recently taken control of this company, a manufacturer of assorted cocoa-based items. He had then initiated a one-of-a-kind tender, offering 80 pounds of cocoa beans for each share of Rockwood stock. I described this transaction in a section of the 1988 annual report that explained arbitrage. I also told you that Jay Pritzker – the young fellow mentioned above – was the business genius behind this tax-efficient idea, the possibilities for which had escaped all the other experts who had thought about buying Rockwood, including my bosses, Ben and Jerry.

At the meeting, Jay was friendly and gave me an education on the 1954 tax code. I came away very impressed. Thereafter, I avidly followed Jay's business dealings, which were many and brilliant. His valued partner was his brother, Bob, who for nearly 50 years ran Marmon Group, the home for most of the Pritzker businesses.

Jay died in 1999, and Bob retired early in 2002. Around then, the Pritzker family decided to gradually sell or reorganize certain of its holdings, including Marmon, a company operating 125 businesses, managed through nine sectors. Marmon's largest operation is Union Tank Car, which together with a Canadian counterpart owns 94,000 rail cars that are leased to various shippers. The original cost of this fleet is $5.1 billion. All told, Marmon has $7 billion in sales and about 20,000 employees.

We will soon purchase 60% of Marmon and will acquire virtually all of the balance within six years. Our initial outlay will be $4.5 billion, and the price of our later purchases will be based on a formula tied to earnings. Prior to our entry into the picture, the Pritzker family received substantial consideration from Marmon's distribution of cash, investments and certain businesses.

This deal was done in the way Jay would have liked. We arrived at a price using only Marmon's financial statements, employing no advisors and engaging in no nit-picking. I knew that the business would be exactly as the Pritzkers represented, and they knew that we would close on the dot, however chaotic financial markets might be. During the past year, many large deals have been renegotiated or killed entirely. With the Pritzkers, as with Berkshire, a deal is a deal.

Marmon's CEO, Frank Ptak, works closely with a long-time associate, John Nichols. John was formerly the highly successful CEO of Illinois Tool Works (ITW), where he teamed with Frank to run a mix of industrial businesses. Take a look at their ITW record; you'll be impressed.

Byron Trott of Goldman Sachs – whose praises I sang in the 2003 report – facilitated the Marmon transaction. Byron is the rare investment banker who puts himself in his client's shoes. Charlie and I trust him completely.

You'll like the code name that Goldman Sachs assigned the deal. Marmon entered the auto business in 1902 and exited it in 1933. Along the way it manufactured the Wasp, a car that won the first Indianapolis 500 race, held in 1911. So this deal was labeled "Indy 500."

* * * * * * * * * * * *

In May 2006, I spoke at a lunch at Ben Bridge, our Seattle-based jewelry chain. The audience was a number of its vendors, among them Dennis Ulrich, owner of a company that manufactured gold jewelry.

In January 2007, Dennis called me, suggesting that with Berkshire's support he could build a large jewelry supplier. We soon made a deal for his business, simultaneously purchasing a supplier of about equal size. The new company, Richline Group, has since made two smaller acquisitions. Even with those, Richline is far below the earnings threshold we normally require for purchases. I'm willing to bet, however, that Dennis – with the help of his partner, Dave Meleski – will build a large operation, earning good returns on capital employed.

Businesses – The Great, the Good and the Gruesome

Let's take a look at what kind of businesses turn us on. And while we're at it, let's also discuss what we wish to avoid.

Charlie and I look for companies that have a) a business we understand; b) favorable long-term economics; c) able and trustworthy management; and d) a sensible price tag. We like to buy the whole business or, if management is our partner, at least 80%. When control-type purchases of quality aren't available, though, we are also happy to simply buy small portions of great businesses by way of stock-market purchases. It's better to have a part interest in the Hope Diamond than to own all of a rhinestone.

A truly great business must have an enduring "moat" that protects excellent returns on invested capital. The dynamics of capitalism guarantee that competitors will repeatedly assault any business "castle" that is earning high returns. Therefore a formidable barrier such as a company's being the low-cost producer (GEICO, Costco) or possessing a powerful world-wide brand (Coca-Cola, Gillette, American Express) is essential for sustained success. Business history is filled with "Roman Candles," companies whose moats proved illusory and were soon crossed.

Our criterion of "enduring" causes us to rule out companies in industries prone to rapid and continuous change. Though capitalism's "creative destruction" is highly beneficial for society, it precludes investment certainty. A moat that must be continuously rebuilt will eventually be no moat at all.

Additionally, this criterion eliminates the business whose success *depends* on having a great manager. Of course, a terrific CEO is a huge asset for any enterprise, and at Berkshire we have an abundance of these managers. Their abilities have created billions of dollars of value that would never have materialized if typical CEOs had been running their businesses.

But if a business *requires* a superstar to produce great results, the business itself cannot be deemed great. A medical partnership led by your area's premier brain surgeon may enjoy outsized and growing earnings, but that tells little about its future. The partnership's moat will go when the surgeon goes. You can count, though, on the moat of the Mayo Clinic to endure, even though you can't name its CEO.

Long-term competitive advantage in a stable industry is what we seek in a business. If that comes with rapid organic growth, great. But even without organic growth, such a business is rewarding. We will simply take the lush earnings of the business and use them to buy similar businesses elsewhere. There's no rule that you have to invest money where you've earned it. Indeed, it's often a mistake to do so: Truly great businesses, earning huge returns on tangible assets, *can't* for any extended period reinvest a large portion of their earnings internally at high rates of return.

Let's look at the prototype of a dream business, our own See's Candy. The boxed-chocolates industry in which it operates is unexciting: Per-capita consumption in the U.S. is extremely low and doesn't grow. Many once-important brands have disappeared, and only three companies have earned more than token profits over the last forty years. Indeed, I believe that See's, though it obtains the bulk of its revenues from only a few states, accounts for nearly half of the entire industry's earnings.

At See's, annual sales were 16 million pounds of candy when Blue Chip Stamps purchased the company in 1972. (Charlie and I controlled Blue Chip at the time and later merged it into Berkshire.) Last year See's sold 31 million pounds, a growth rate of only 2% annually. Yet its durable competitive advantage, built by the See's family over a 50-year period, and strengthened subsequently by Chuck Huggins and Brad Kinstler, has produced extraordinary results for Berkshire.

We bought See's for $25 million when its sales were $30 million and pre-tax earnings were less than $5 million. The capital then required to conduct the business was $8 million. (Modest seasonal debt was also needed for a few months each year.) Consequently, the company was earning 60% pre-tax on invested capital. Two factors helped to minimize the funds required for operations. First, the product was sold for cash, and that eliminated accounts receivable. Second, the production and distribution cycle was short, which minimized inventories.

Last year See's sales were $383 million, and pre-tax profits were $82 million. The capital now required to run the business is $40 million. This means we have had to reinvest only $32 million since 1972 to handle the modest physical growth – and somewhat immodest financial growth – of the business. In the meantime pre-tax earnings have totaled $1.35 billion. *All of that*, except for the $32 million, has been sent to Berkshire (or, in the early years, to Blue Chip). After paying corporate taxes on the profits, we have used the rest to buy other attractive businesses. Just as Adam and Eve kick-started an activity that led to six billion humans, See's has given birth to multiple new streams of cash for us. (The biblical command to "be fruitful and multiply" is one we take seriously at Berkshire.)

There aren't many See's in Corporate America. Typically, companies that increase their earnings from $5 million to $82 million require, say, $400 million or so of capital investment to finance their growth. That's because growing businesses have both working capital needs that increase in proportion to sales growth and significant requirements for fixed asset investments.

A company that needs large increases in capital to engender its growth may well prove to be a satisfactory investment. There is, to follow through on our example, nothing shabby about earning $82 million pre-tax on $400 million of net tangible assets. But that equation for the owner is vastly different from the See's situation. It's far better to have an ever-increasing stream of earnings with virtually no major capital requirements. Ask Microsoft or Google.

One example of good, but far from sensational, business economics is our own FlightSafety. This company delivers benefits to its customers that are the equal of those delivered by any business that I know of. It also possesses a durable competitive advantage: Going to any other flight-training provider than the best is like taking the low bid on a surgical procedure.

Nevertheless, this business requires a significant reinvestment of earnings if it is to grow. When we purchased FlightSafety in 1996, its pre-tax operating earnings were $111 million, and its net investment in fixed assets was $570 million. Since our purchase, depreciation charges have totaled $923 million. But capital expenditures have totaled $1.635 billion, most of that for simulators to match the new airplane models that are constantly being introduced. (A simulator can cost us more than $12 million, and we have 273 of them.) Our fixed assets, after depreciation, now amount to $1.079 billion. Pre-tax operating earnings in 2007 were $270 million, a gain of $159 million since 1996. That gain gave us a good, but far from See's-like, return on our incremental investment of $509 million.

Consequently, if measured only by economic returns, FlightSafety is an excellent but not extraordinary business. Its put-up-more-to-earn-more experience is that faced by most corporations. For example, our large investment in regulated utilities falls squarely in this category. We will earn considerably more money in this business ten years from now, but we will invest many billions to make it.

Now let's move to the gruesome. The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines. Here a *durable* competitive advantage has proven elusive ever since the days of the Wright Brothers. Indeed, if a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favor by shooting Orville down.

The airline industry's demand for capital ever since that first flight has been insatiable. Investors have poured money into a bottomless pit, attracted by growth when they should have been repelled by it. And I, to my shame, participated in this foolishness when I had Berkshire buy U.S. Air preferred stock in 1989. As the ink was drying on our check, the company went into a tailspin, and before long our preferred dividend was no longer being paid. But we then got very lucky. In one of the recurrent, but always misguided, bursts of optimism for airlines, we were actually able to sell our shares in 1998 for a hefty gain. In the decade following our sale, the company went bankrupt. Twice.

To sum up, think of three types of "savings accounts." The great one pays an extraordinarily high interest rate that will rise as the years pass. The good one pays an attractive rate of interest that will be earned also on deposits that are added. Finally, the gruesome account both pays an inadequate interest rate and requires you to keep adding money at those disappointing returns.

* * * * * * * * * * * *

And now it's confession time. It should be noted that no consultant, board of directors or investment banker pushed me into the mistakes I will describe. In tennis parlance, they were all unforced errors.

To begin with, I almost blew the See's purchase. The seller was asking $30 million, and I was adamant about not going above $25 million. Fortunately, he caved. Otherwise I would have balked, and that $1.35 billion would have gone to somebody else.

About the time of the See's purchase, Tom Murphy, then running Capital Cities Broadcasting, called and offered me the Dallas-Fort Worth NBC station for $35 million. The station came with the Fort Worth paper that Capital Cities was buying, and under the "cross-ownership" rules Murph had to divest it. I knew that TV stations were See's-like businesses that required virtually no capital investment and had excellent prospects for growth. They were simple to run and showered cash on their owners.

Moreover, Murph, then as now, was a close friend, a man I admired as an extraordinary manager and outstanding human being. He knew the television business forward and backward and would not have called me unless he felt a purchase was certain to work. In effect Murph whispered "buy" into my ear. But I didn't listen.

In 2006, the station earned $73 million pre-tax, bringing its total earnings since I turned down the deal to at least $1 billion – almost all available to its owner for other purposes. Moreover, the property now has a capital value of about $800 million. Why did I say "no"? The only explanation is that my brain had gone on vacation and forgot to notify me. (My behavior resembled that of a politician Molly Ivins once described: "If his I.Q. was any lower, you would have to water him twice a day.")

Finally, I made an even worse mistake when I said "yes" to Dexter, a shoe business I bought in 1993 for $433 million in Berkshire stock (25,203 shares of A). What I had assessed as durable competitive advantage vanished within a few years. But that's just the beginning: By using Berkshire stock, I compounded this error hugely. That move made the cost to Berkshire shareholders not $400 million, but rather $3.5 billion. In essence, I gave away 1.6% of a wonderful business – one now valued at $220 billion – to buy a worthless business.

To date, Dexter is the worst deal that I've made. But I'll make more mistakes in the future – you can bet on that. A line from Bobby Bare's country song explains what too often happens with acquisitions: "I've never gone to bed with an ugly woman, but I've sure woke up with a few."

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Now, let's examine the four major operating sectors of Berkshire. Each sector has vastly different balance sheet and income account characteristics. Therefore, lumping them together impedes analysis. So we'll present them as four separate businesses, which is how Charlie and I view them.

Insurance

The best anecdote I've heard during the current presidential campaign came from Mitt Romney, who asked his wife, Ann, "When we were young, did you ever in your wildest dreams think I might be president?" To which she replied, "Honey, you weren't *in* my wildest dreams."

When we first entered the property/casualty insurance business in 1967, my wildest dreams did not envision our current operation. Here's how we did in the first five years after purchasing National Indemnity:

Year	*Underwriting Profit (Loss)*	*Float*
	(in millions)	
1967	$ 0.4	$18.5
1968	0.6	21.3
1969	0.1	25.4
1970	(0.4)	39.4
1971	1.4	65.6

To put it charitably, we were a slow starter. But things changed. Here's the record of the last five years:

Year	*Underwriting Profit (Loss)*	*Float*
	(in millions)	
2003	$1,718	$44,220
2004	1,551	46,094
2005	53	49,287
2006	3,838	50,887
2007	3,374	58,698

This metamorphosis has been accomplished by some extraordinary managers. Let's look at what each has achieved.

- GEICO possesses the widest moat of any of our insurers, one carefully protected and expanded by Tony Nicely, its CEO. Last year – again – GEICO had the best growth record among major auto insurers, increasing its market share to 7.2%. When Berkshire acquired control in 1995, that share was 2.5%. Not coincidentally, annual ad expenditures by GEICO have increased from $31 million to $751 million during the same period.

  Tony, now 64, joined GEICO at 18. Every day since, he has been passionate about the company – proud of how it could both save money for its customers and provide growth opportunities for its associates. Even now, with sales at $12 billion, Tony feels GEICO is just getting started. So do I.

  Here's some evidence. In the last three years, GEICO has increased its share of the motorcycle market from 2.1% to 6%. We've also recently begun writing policies on ATVs and RVs. And in November we wrote our first *commercial* auto policy. GEICO and National Indemnity are working together in the commercial field, and early results are very encouraging.

  Even in aggregate, these lines will remain a small fraction of our personal auto volume. Nevertheless, they should deliver a growing stream of underwriting profits and float.

- General Re, our international reinsurer, is by far our largest source of "home-grown" float – $23 billion at yearend. This operation is now a huge asset for Berkshire. Our ownership, however, had a shaky start.

  For decades, General Re was the Tiffany of reinsurers, admired by all for its underwriting skills and discipline. This reputation, unfortunately, outlived its factual underpinnings, a flaw that I completely missed when I made the decision in 1998 to merge with General Re. The General Re of 1998 was not operated as the General Re of 1968 or 1978.

  Now, thanks to Joe Brandon, General Re's CEO, and his partner, Tad Montross, the luster of the company has been restored. Joe and Tad have been running the business for six years and have been doing first-class business in a first-class way, to use the words of J. P. Morgan. They have restored discipline to underwriting, reserving and the selection of clients.

  Their job was made more difficult by costly and time-consuming legacy problems, both in the U.S. and abroad. Despite that diversion, Joe and Tad have delivered excellent underwriting results while skillfully repositioning the company for the future.

- Since joining Berkshire in 1986, Ajit Jain has built a truly great specialty reinsurance operation from scratch. For one-of-a-kind mammoth transactions, the world now turns to him.

  Last year I told you in detail about the Equitas transfer of huge, but capped, liabilities to Berkshire for a single premium of $7.1 billion. At this very early date, our experience has been good. But this doesn't tell us much because it's just one straw in a fifty-year-or-more wind. What we know for sure, however, is that the London team who joined us, headed by Scott Moser, is first-rate and has become a valuable asset for our insurance business.

- Finally, we have our smaller operations, which serve specialized segments of the insurance market. In aggregate, these companies have performed extraordinarily well, earning above-average underwriting profits and delivering valuable float for investment.

  Last year BoatU.S., headed by Bill Oakerson, was added to the group. This company manages an association of about 650,000 boat owners, providing them services similar to those offered by AAA auto clubs to drivers. Among the association's offerings is boat insurance. Learn more about this operation by visiting its display at the annual meeting.

Below we show the record of our four categories of property/casualty insurance.

	Underwriting Profit		Yearend Float	
	(in millions)			
Insurance Operations	2007	2006	2007	2006
General Re	$ 555	$ 526	$23,009	$22,827
BH Reinsurance	1,427	1,658	23,692	16,860
GEICO	1,113	1,314	7,768	7,171
Other Primary	279	340*	4,229	4,029*
	$3,374	$3,838	$58,698	$50,887

* Includes Applied Underwriters from May 19, 2006.

Regulated Utility Business

Berkshire has an 87.4% (diluted) interest in MidAmerican Energy Holdings, which owns a wide variety of utility operations. The largest of these are (1) Yorkshire Electricity and Northern Electric, whose 3.8 million electric customers make it the third largest distributor of electricity in the U.K.; (2) MidAmerican Energy, which serves 720,000 electric customers, primarily in Iowa; (3) Pacific Power and Rocky Mountain Power, serving about 1.7 million electric customers in six western states; and (4) Kern River and Northern Natural pipelines, which carry about 8% of the natural gas consumed in the U.S.

Our partners in ownership of MidAmerican are Walter Scott, and its two terrific managers, Dave Sokol and Greg Abel. It's unimportant how many votes each party has; we make major moves only when we are unanimous in thinking them wise. Eight years of working with Dave, Greg and Walter have underscored my original belief: Berkshire couldn't have better partners.

Somewhat incongruously, MidAmerican also owns the second largest real estate brokerage firm in the U.S., HomeServices of America. This company operates through 20 locally-branded firms with 18,800 agents. Last year was a slow year for residential sales, and 2008 will probably be slower. We will continue, however, to acquire quality brokerage operations when they are available at sensible prices.

Here are some key figures on MidAmerican's operation:

	Earnings (in millions)	
	2007	2006
U.K. utilities	$ 337	$ 338
Iowa utility	412	348
Western utilities (acquired March 21, 2006)	692	356
Pipelines	473	376
HomeServices	42	74
Other (net)	130	245
Earnings before corporate interest and taxes	2,086	1,737
Interest, other than to Berkshire	(312)	(261)
Interest on Berkshire junior debt	(108)	(134)
Income tax	(477)	(426)
Net earnings	$ 1,189	$ 916
Earnings applicable to Berkshire*	$ 1,114	$ 885
Debt owed to others	19,002	16,946
Debt owed to Berkshire	821	1,055

*Includes interest earned by Berkshire (net of related income taxes) of $70 in 2007 and $87 in 2006.

We agreed to purchase 35,464,337 shares of MidAmerican at $35.05 per share in 1999, a year in which its per-share earnings were $2.59. Why the odd figure of $35.05? I originally decided the business was worth $35.00 per share to Berkshire. Now, I'm a "one-price" guy (remember See's?) and for several days the investment bankers representing MidAmerican had no luck in getting me to increase Berkshire's offer. But, finally, they caught me in a moment of weakness, and I caved, telling them I would go to $35.05. With that, I explained, they could tell their client they had wrung the last nickel out of me. At the time, it hurt.

Later on, in 2002, Berkshire purchased 6,700,000 shares at $60 to help finance the acquisition of one of our pipelines. Lastly, in 2006, when MidAmerican bought PacifiCorp, we purchased 23,268,793 shares at $145 per share.

In 2007, MidAmerican earned $15.78 per share. However, 77¢ of that was non-recurring – a reduction in deferred tax at our British utility, resulting from a lowering of the U.K. corporate tax rate. So call normalized earnings $15.01 per share. And yes, I'm glad I wilted and offered the extra nickel.

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/07 (in millions)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 2,080	Notes payable	$ 1,278
Accounts and notes receivable	4,488	Other current liabilities	7,652
Inventory	5,793	Total current liabilities	8,930
Other current assets	470		
Total current assets	12,831		
Goodwill and other intangibles	14,201	Deferred taxes	828
Fixed assets	9,605	Term debt and other liabilities	3,079
Other assets	1,685	Equity	25,485
	$38,322		$38,322

Earnings Statement (in millions)

	2007	*2006*	*2005*
Revenues	$59,100	$52,660	$46,896
Operating expenses (including depreciation of $955 in 2007, $823 in 2006 and $699 in 2005)	55,026	49,002	44,190
Interest expense	127	132	83
Pre-tax earnings	3,947*	3,526*	2,623*
Income taxes and minority interests	1,594	1,395	977
Net income	$ 2,353	$ 2,131	$ 1,646

*Does not include purchase-accounting adjustments.

This motley group, which sells products ranging from lollipops to motor homes, earned a pleasing 23% on average tangible net worth last year. It's noteworthy also that these operations used only minor financial leverage in achieving that return. Clearly we own some terrific businesses. We purchased many of them, however, at large premiums to net worth – a point reflected in the goodwill item shown on the balance sheet – and that fact reduces the earnings on our average *carrying* value to 9.8%.

Here are a few newsworthy items about companies in this sector:

- Shaw, Acme Brick, Johns Manville and MiTek were all hurt in 2007 by the sharp housing downturn, with their pre-tax earnings declining 27%, 41%, 38%, and 9% respectively. Overall, these companies earned $941 million pre-tax compared to $1.296 billion in 2006.

  Last year, Shaw, MiTek and Acme contracted for tuck-in acquisitions that will help future earnings. You can be sure they will be looking for more of these.

- In a tough year for retailing, our standouts were See's, Borsheims and Nebraska Furniture Mart.

  Two years ago Brad Kinstler was made CEO of See's. We very seldom move managers from one industry to another at Berkshire. But we made an exception with Brad, who had previously run our uniform company, Fechheimer, and Cypress Insurance. The move could not have worked out better. In his two years, profits at See's have increased more than 50%.

  At Borsheims, sales increased 15.1%, helped by a 27% gain during Shareholder Weekend. Two years ago, Susan Jacques suggested that we remodel and expand the store. I was skeptical, but Susan was right.

  Susan came to Borsheims 25 years ago as a $4-an-hour saleswoman. Though she lacked a managerial background, I did not hesitate to make her CEO in 1994. She's smart, she loves the business, and she loves her associates. That beats having an MBA degree any time.

  (An aside: Charlie and I are not big fans of resumes. Instead, we focus on brains, passion and integrity. Another of our great managers is Cathy Baron Tamraz, who has significantly increased Business Wire's earnings since we purchased it early in 2006. She is an owner's dream. It is positively *dangerous* to stand between Cathy and a business prospect. Cathy, it should be noted, began her career as a cab driver.)

  Finally, at Nebraska Furniture Mart, earnings hit a record as our Omaha and Kansas City stores each had sales of about $400 million. These, by some margin, are the two top home furnishings stores in the country. In a disastrous year for many furniture retailers, sales at Kansas City increased 8%, while in Omaha the gain was 6%.

  Credit the remarkable Blumkin brothers, Ron and Irv, for this performance. Both are close personal friends of mine and great businessmen.

- Iscar continues its wondrous ways. Its products are small carbide cutting tools that make large and very expensive machine tools more productive. The raw material for carbide is tungsten, mined in China. For many decades, Iscar moved tungsten to Israel, where brains turned it into something far more valuable. Late in 2007, Iscar opened a large plant in Dalian, China. In effect, we've now moved the brains to the tungsten. Major opportunities for growth await Iscar. Its management team, led by Eitan Wertheimer, Jacob Harpaz, and Danny Goldman, is certain to make the most of them.

- Flight services set a record in 2007 with pre-tax earnings increasing 49% to $547 million. Corporate aviation had an extraordinary year worldwide, and both of our companies – as runaway leaders in their fields – fully participated.

  FlightSafety, our pilot training business, gained 14% in revenues and 20% in pre-tax earnings. We estimate that we train about 58% of U.S. corporate pilots. Bruce Whitman, the company's CEO, inherited this leadership position in 2003 from Al Ueltschi, the father of advanced flight training, and has proved to be a worthy successor.

At NetJets, the inventor of fractional-ownership of jets, we also remain the unchallenged leader. We now operate 487 planes in the U.S. and 135 in Europe, a fleet more than twice the size of that operated by our three major competitors *combined.* Because our share of the large-cabin market is near 90%, our lead in value terms is far greater.

The NetJets brand – with its promise of safety, service and security – grows stronger every year. Behind this is the passion of one man, Richard Santulli. If you were to pick someone to join you in a foxhole, you couldn't do better than Rich. No matter what the obstacles, he just doesn't stop.

Europe is the best example of how Rich's tenacity leads to success. For the first ten years we made little financial progress there, actually running up cumulative losses of $212 million. After Rich brought Mark Booth on board to run Europe, however, we began to gain traction. Now we have real momentum, and last year earnings tripled.

In November, our directors met at NetJets headquarters in Columbus and got a look at the sophisticated operation there. It is responsible for 1,000 or so flights a day in all kinds of weather, with customers expecting top-notch service. Our directors came away impressed by the facility and its capabilities – but even more impressed by Rich and his associates.

Finance and Finance Products

Our major operation in this category is Clayton Homes, the largest U.S. manufacturer and marketer of manufactured homes. Clayton's market share hit a record 31% last year. But industry volume continues to shrink: Last year, manufactured home sales were 96,000, down from 131,000 in 2003, the year we bought Clayton. (At the time, it should be remembered, some commentators criticized its directors for selling at a cyclical bottom.)

Though Clayton earns money from both manufacturing and retailing its homes, most of its earnings come from an $11 billion loan portfolio, covering 300,000 borrowers. That's why we include Clayton's operation in this finance section. Despite the many problems that surfaced during 2007 in real estate finance, the Clayton portfolio is performing well. Delinquencies, foreclosures and losses during the year were at rates similar to those we experienced in our previous years of ownership.

Clayton's loan portfolio is financed by Berkshire. For this funding, we charge Clayton one percentage point over Berkshire's borrowing cost – a fee that amounted to $85 million last year. Clayton's 2007 pre-tax earnings of $526 million are *after* its paying this fee. The flip side of this transaction is that Berkshire recorded $85 million as income, which is included in "other" in the following table.

	Pre-Tax Earnings (in millions)	
	2007	*2006*
Trading – ordinary income	$ 272	$ 274
Life and annuity operation	(60)	29
Leasing operations	111	182
Manufactured-housing finance (Clayton)	526	513
Other	157	159
Income before capital gains	1,006	1,157
Trading – capital gains	105	938
	$1,111	$2,095

The leasing operations tabulated are XTRA, which rents trailers, and CORT, which rents furniture. Utilization of trailers was down considerably in 2007 and that led to a drop in earnings at XTRA. That company also borrowed $400 million last year and distributed the proceeds to Berkshire. The resulting higher interest it is now paying further reduced XTRA's earnings.

Clayton, XTRA and CORT are all good businesses, very ably run by Kevin Clayton, Bill Franz and Paul Arnold. Each has made tuck-in acquisitions during Berkshire's ownership. More will come.

Investments

We show below our common stock investments at yearend, itemizing those with a market value of at least $600 million.

			12/31/07	
Shares	*Company*	*Percentage of Company Owned*	*Cost**	*Market*
			(in millions)	
151,610,700	American Express Company	13.1	$ 1,287	$ 7,887
35,563,200	Anheuser-Busch Companies, Inc.	4.8	1,718	1,861
60,828,818	Burlington Northern Santa Fe	17.5	4,731	5,063
200,000,000	The Coca-Cola Company	8.6	1,299	12,274
17,508,700	Conoco Phillips	1.1	1,039	1,546
64,271,948	Johnson & Johnson	2.2	3,943	4,287
124,393,800	Kraft Foods Inc.	8.1	4,152	4,059
48,000,000	Moody's Corporation	19.1	499	1,714
3,486,006	POSCO	4.5	572	2,136
101,472,000	The Procter & Gamble Company	3.3	1,030	7,450
17,170,953	Sanofi-Aventis	1.3	1,466	1,575
227,307,000	Tesco plc	2.9	1,326	2,156
75,176,026	U.S. Bancorp	4.4	2,417	2,386
17,072,192	USG Corp	17.2	536	611
19,944,300	Wal-Mart Stores, Inc.	0.5	942	948
1,727,765	The Washington Post Company	18.2	11	1,367
303,407,068	Wells Fargo & Company	9.2	6,677	9,160
1,724,200	White Mountains Insurance Group Ltd.	16.3	369	886
	Others		5,238	7,633
	Total Common Stocks		$39,252	$74,999

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

Overall, we are delighted by the business performance of our investees. In 2007, American Express, Coca-Cola and Procter & Gamble, three of our four largest holdings, increased per-share earnings by 12%, 14% and 14%. The fourth, Wells Fargo, had a small decline in earnings because of the popping of the real estate bubble. Nevertheless, I believe its intrinsic value increased, even if only by a minor amount.

In the strange world department, note that American Express and Wells Fargo were both organized by Henry Wells and William Fargo, Amex in 1850 and Wells in 1852. P&G and Coke began business in 1837 and 1886 respectively. Start-ups are not our game.

I should emphasize that we do not measure the progress of our investments by what their market prices do during any given year. Rather, we evaluate their performance by the two methods we apply to the businesses we own. The first test is improvement in earnings, with our making due allowance for industry conditions. The second test, more subjective, is whether their "moats" – a metaphor for the superiorities they possess that make life difficult for their competitors – have widened during the year. All of the "big four" scored positively on that test.

We made one large sale last year. In 2002 and 2003 Berkshire bought 1.3% of PetroChina for $488 million, a price that valued the entire business at about $37 billion. Charlie and I then felt that the company was worth about $100 billion. By 2007, two factors had materially increased its value: the price of oil had climbed significantly, and PetroChina's management had done a great job in building oil and gas reserves. In the second half of last year, the market value of the company rose to $275 billion, about what we thought it was worth compared to other giant oil companies. So we sold our holdings for $4 billion.

A footnote: We paid the IRS tax of $1.2 billion on our PetroChina gain. This sum paid *all* costs of the U.S. government – defense, social security, you name it – for about four hours.

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Last year I told you that Berkshire had 62 derivative contracts that I manage. (We also have a few left in the General Re runoff book.) Today, we have 94 of these, and they fall into two categories.

First, we have written 54 contracts that require us to make payments if certain bonds that are included in various high-yield indices default. These contracts expire at various times from 2009 to 2013. At yearend we had received $3.2 billion in premiums on these contracts; had paid $472 million in losses; and in the worst case (though it is extremely unlikely to occur) could be required to pay an additional $4.7 billion.

We are certain to make many more payments. But I believe that on premium revenues alone, these contracts will prove profitable, leaving aside what we can earn on the large sums we hold. Our yearend liability for this exposure was recorded at $1.8 billion and is included in "Derivative Contract Liabilities" on our balance sheet.

The second category of contracts involves various put options we have sold on four stock indices (the S&P 500 plus three foreign indices). These puts had original terms of either 15 or 20 years and were struck at the market. We have received premiums of $4.5 billion, and we recorded a liability at yearend of $4.6 billion. The puts in these contracts are exercisable *only* at their expiration dates, which occur between 2019 and 2027, and Berkshire will then need to make a payment only if the index in question is quoted at a level below that existing on the day that the put was written. Again, I believe these contracts, in aggregate, will be profitable and that we will, in addition, receive substantial income from our investment of the premiums we hold during the 15- or 20-year period.

Two aspects of our derivative contracts are particularly important. First, in all cases we hold the money, which means that we have *no* counterparty risk.

Second, accounting rules for our derivative contracts differ from those applying to our investment portfolio. In that portfolio, changes in value are applied to the net worth shown on Berkshire's balance sheet, but do not affect earnings unless we sell (or write down) a holding. Changes in the value of a derivative contract, however, must be applied each quarter to earnings.

Thus, our derivative positions will sometimes cause large swings in reported earnings, even though Charlie and I might believe the intrinsic value of these positions has changed little. He and I will not be bothered by these swings – even though they could easily amount to $1 billion or more in a quarter – and we hope you won't be either. You will recall that in our catastrophe insurance business, we are always ready to trade increased volatility in reported earnings in the short run for greater gains in net worth in the long run. That is our philosophy in derivatives as well.

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The U.S. dollar weakened further in 2007 against major currencies, and it's no mystery why: Americans like buying products made elsewhere more than the rest of the world likes buying products made in the U.S. Inevitably, that causes America to ship about $2 billion of IOUs and assets *daily* to the rest of the world. And over time, that puts pressure on the dollar.

When the dollar falls, it both makes our products cheaper for foreigners to buy and their products more expensive for U.S. citizens. That's why a falling currency is supposed to cure a trade deficit. Indeed, the U.S. deficit has undoubtedly been tempered by the large drop in the dollar. But ponder this: In 2002 when the Euro averaged 94.6¢, our trade deficit with Germany (the fifth largest of our trading partners) was $36 billion, whereas in 2007, with the Euro averaging $1.37, our deficit with Germany was up to $45 billion. Similarly, the Canadian dollar averaged 64¢ in 2002 and 93¢ in 2007. Yet our trade deficit with Canada rose as well, from $50 billion in 2002 to $64 billion in 2007. So far, at least, a plunging dollar has not done much to bring our trade activity into balance.

There's been much talk recently of sovereign wealth funds and how they are buying large pieces of American businesses. This is *our* doing, not some nefarious plot by foreign governments. Our trade equation guarantees massive foreign investment in the U.S. When we force-feed $2 billion daily to the rest of the world, they must invest in *something* here. Why should we complain when they choose stocks over bonds?

Our country's weakening currency is not the fault of OPEC, China, etc. Other developed countries rely on imported oil and compete against Chinese imports just as we do. In developing a sensible trade policy, the U.S. should not single out countries to punish or industries to protect. Nor should we take actions likely to evoke retaliatory behavior that will reduce America's exports, true trade that benefits both our country and the rest of the world.

Our legislators should recognize, however, that the current imbalances are unsustainable and should therefore adopt policies that will materially reduce them sooner rather than later. Otherwise our $2 billion daily of force-fed dollars to the rest of the world may produce global indigestion of an unpleasant sort. (For other comments about the unsustainability of our trade deficits, see Alan Greenspan's comments on November 19, 2004, the Federal Open Market Committee's minutes of June 29, 2004, and Ben Bernanke's statement on September 11, 2007.)

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At Berkshire we held only one direct currency position during 2007. That was in – hold your breath – the Brazilian real. Not long ago, swapping dollars for reals would have been unthinkable. After all, during the past century *five* versions of Brazilian currency have, in effect, turned into confetti. As has been true in many countries whose currencies have periodically withered and died, wealthy Brazilians sometimes stashed large sums in the U.S. to preserve their wealth.

But any Brazilian who followed this apparently prudent course would have lost *half* his net worth over the past five years. Here's the year-by-year record (indexed) of the real versus the dollar from the end of 2002 to yearend 2007: 100; 122; 133; 152; 166; 199. Every year the real went up and the dollar fell. Moreover, during much of this period the Brazilian government was actually holding down the value of the real and supporting *our* currency by buying dollars in the market.

Our direct currency positions have yielded $2.3 billion of pre-tax profits over the past five years, and in addition we have profited by holding bonds of U.S. companies that are denominated in other currencies. For example, in 2001 and 2002 we purchased €310 million Amazon.com, Inc. 6 7/8 of 2010 at 57% of par. At the time, Amazon bonds were priced as "junk" credits, though they were anything but. (Yes, Virginia, you can occasionally find markets that are ridiculously inefficient – or at least you can find them anywhere except at the finance departments of some leading business schools.)

The Euro denomination of the Amazon bonds was a further, and important, attraction for us. The Euro was at 95¢ when we bought in 2002. Therefore, our cost in dollars came to only $169 million. Now the bonds sell at 102% of par and the Euro is worth $1.47. In 2005 and 2006 some of our bonds were called and we received $253 million for them. Our remaining bonds were valued at $162 million at yearend. Of our $246 million of realized and unrealized gain, about $118 million is attributable to the fall in the dollar. Currencies do matter.

At Berkshire, we will attempt to further increase our stream of direct and indirect foreign earnings. Even if we are successful, however, our assets and earnings will always be concentrated in the U.S. Despite our country's many imperfections and unrelenting problems of one sort or another, America's rule of law, market-responsive economic system, and belief in meritocracy are almost certain to produce ever-growing prosperity for its citizens.

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As I have told you before, we have for some time been well-prepared for CEO succession because we have three outstanding internal candidates. The board knows exactly whom it would pick if I were to become unavailable, either because of death or diminishing abilities. And that would still leave the board with two backups.

Last year I told you that we would also promptly complete a succession plan for the investment job at Berkshire, and we have indeed now identified four candidates who could succeed me in managing investments. All manage substantial sums currently, and all have indicated a strong interest in coming to Berkshire if called. The board knows the strengths of the four and would expect to hire one or more if the need arises. The candidates are young to middle-aged, well-to-do to rich, and all wish to work for Berkshire for reasons that go beyond compensation.

(I've reluctantly discarded the notion of my continuing to manage the portfolio after my death – abandoning my hope to give new meaning to the term "thinking outside the box.")

Fanciful Figures – How Public Companies Juice Earnings

Former Senator Alan Simpson famously said: "Those who travel the high road in Washington need not fear heavy traffic." If he had sought truly deserted streets, however, the Senator should have looked to Corporate America's accounting.

An important referendum on which road businesses prefer occurred in 1994. America's CEOs had just strong-armed the U.S. Senate into ordering the Financial Accounting Standards Board to shut up, by a vote that was 88-9. Before that rebuke the FASB had shown the audacity – by unanimous agreement, no less – to tell corporate chieftains that the stock options they were being awarded represented a form of compensation and that their value should be recorded as an expense.

After the senators voted, the FASB – now educated on accounting principles by the Senate's 88 closet CPAs – decreed that companies could choose between two methods of reporting on options. The *preferred* treatment would be to expense their value, but it would also be allowable for companies to ignore the expense as long as their options were issued at market value.

A moment of truth had now arrived for America's CEOs, and their reaction was not a pretty sight. During the next six years, exactly *two* of the 500 companies in the S&P chose the preferred route. CEOs of the rest opted for the low road, thereby ignoring a large and obvious expense in order to report higher "earnings." I'm sure some of them also felt that if they opted for expensing, their directors might in future years think twice before approving the mega-grants the managers longed for.

It turned out that for many CEOs even the low road wasn't good enough. Under the weakened rule, there remained earnings consequences if options were issued with a strike price below market value. No problem. To avoid that bothersome rule, a number of companies surreptitiously backdated options to falsely indicate that they were granted at current market prices, when in fact they were dished out at prices well below market.

Decades of option-accounting nonsense have now been put to rest, but other accounting choices remain – important among these the investment-return assumption a company uses in calculating pension expense. It will come as no surprise that many companies continue to choose an assumption that allows them to report less-than-solid "earnings." For the 363 companies in the S&P that have pension plans, this assumption in 2006 averaged 8%. Let's look at the chances of that being achieved.

The average holdings of bonds and cash for all pension funds is about 28%, and on these assets returns can be expected to be no more than 5%. Higher yields, of course, are obtainable but they carry with them a risk of commensurate (or greater) loss.

This means that the remaining 72% of assets – which are mostly in equities, either held directly or through vehicles such as hedge funds or private-equity investments – must earn 9.2% in order for the fund overall to achieve the postulated 8%. And that return must be delivered *after* all fees, which are now far higher than they have ever been.

How realistic is this expectation? Let's revisit some data I mentioned two years ago: During the 20th Century, the Dow advanced from 66 to 11,497. This gain, though it appears huge, shrinks to 5.3% when compounded annually. An investor who owned the Dow throughout the century would also have received generous dividends for much of the period, but only about 2% or so in the final years. It was a wonderful century.

Think now about *this* century. For investors to merely match that 5.3% market-value gain, the Dow – recently below 13,000 – would need to close at about *2,000,000* on December 31, 2099. We are now eight years into this century, and we have racked up less than 2,000 of the 1,988,000 Dow points the market needed to travel in this hundred years to equal the 5.3% of the last.

It's amusing that commentators regularly hyperventilate at the prospect of the Dow crossing an even number of thousands, such as 14,000 or 15,000. If they keep reacting that way, a 5.3% annual gain for the century will mean they experience at least 1,986 seizures during the next 92 years. While anything is possible, does anyone really believe this is the most likely outcome?

Dividends continue to run about 2%. Even if stocks were to average the 5.3% annual appreciation of the 1900s, the equity portion of plan assets – allowing for expenses of .5% – would produce no more than 7% or so. And .5% may well understate costs, given the presence of layers of consultants and high-priced managers ("helpers").

Naturally, everyone expects to be above average. And those helpers – bless their hearts – will certainly encourage their clients in this belief. But, as a class, the helper-aided group must be *below* average. The reason is simple: 1) Investors, overall, will necessarily earn an average return, minus costs they incur; 2) Passive and index investors, through their very inactivity, will earn that average minus costs that are very low; 3) With that group earning average returns, so must the remaining group – the active investors. But this group will incur high transaction, management, and advisory costs. Therefore, the active investors will have their returns diminished by a far greater percentage than will their inactive brethren. That means that the passive group – the "know-nothings" – must win.

I should mention that people who expect to earn 10% annually from equities during this century – envisioning that 2% of that will come from dividends and 8% from price appreciation – are implicitly forecasting a level of about *24,000,000* on the Dow by 2100. If your adviser talks to you about double-digit returns from equities, explain this math to him – not that it will faze him. Many helpers are apparently direct descendants of the queen in Alice in Wonderland, who said: "Why, sometimes I've believed as many as six impossible things before breakfast." Beware the glib helper who fills your head with fantasies while he fills his pockets with fees.

Some companies have pension plans in Europe as well as in the U.S. and, in their accounting, almost all assume that the U.S. plans will earn more than the non-U.S. plans. This discrepancy is puzzling: Why should these companies not put their U.S. managers in charge of the non-U.S. pension assets and let them work their magic on these assets as well? I've never seen this puzzle explained. But the auditors and actuaries who are charged with vetting the return assumptions seem to have no problem with it.

What is no puzzle, however, is why CEOs opt for a high investment assumption: It lets them report higher earnings. And if they are wrong, as I believe they are, the chickens won't come home to roost until long after they retire.

After decades of pushing the envelope – or worse – in its attempt to report the highest number possible for current earnings, Corporate America should ease up. It should listen to my partner, Charlie: "If you've hit three balls out of bounds to the left, aim a little to the right on the next swing."

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Whatever pension-cost surprises are in store for shareholders down the road, these jolts will be surpassed many times over by those experienced by taxpayers. Public pension promises are huge and, in many cases, funding is woefully inadequate. Because the fuse on this time bomb is long, politicians flinch from inflicting tax pain, given that problems will only become apparent long after these officials have departed. Promises involving very early retirement – sometimes to those in their low 40s – and generous cost-of-living adjustments are easy for these officials to make. In a world where people are living longer and inflation is certain, those promises will be anything but easy to keep.

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Having laid out the failures of an "honor system" in American accounting, I need to point out that this is exactly the system existing at Berkshire for a truly huge balance-sheet item. In every report we make to you, we must guesstimate the loss reserves for our insurance units. If our estimate is wrong, it means that both our balance sheet and our earnings statement will be wrong. So naturally we do our best to make these guesses accurate. *Nevertheless, in every report our estimate is sure to be wrong.*

At yearend 2007, we show an insurance liability of $56 billion that represents our guess as to what we will eventually pay for all loss events that occurred before yearend (except for about $3 billion of the reserve that has been discounted to present value). We know of many thousands of events and have put a dollar value on each that reflects what we believe we will pay, including the associated costs (such as attorney's fees) that we will incur in the payment process. In some cases, among them claims for certain serious injuries covered by worker's compensation, payments will be made for 50 years or more.

We also include a large reserve for losses that occurred before yearend but that we have yet to hear about. Sometimes, the insured itself does not know that a loss has occurred. (Think of an embezzlement that remains undiscovered for years.) We sometimes hear about losses from policies that covered our insured many decades ago.

A story I told you some years back illustrates our problem in accurately estimating our loss liability: A fellow was on an important business trip in Europe when his sister called to tell him that their dad had died. Her brother explained that he couldn't get back but said to spare nothing on the funeral, whose cost he would cover. When he returned, his sister told him that the service had been beautiful and presented him with bills totaling $8,000. He paid up but a month later received a bill from the mortuary for $10. He paid that, too – and still another $10 charge he received a month later. When a third $10 invoice was sent to him the following month, the perplexed man called his sister to ask what was going on. "Oh," she replied, "I forgot to tell you. We buried Dad in a rented suit."

At our insurance companies we have an unknown, but most certainly large, number of "rented suits" buried around the world. We try to estimate the bill for them accurately. In ten or twenty years, we will even be able to make a good guess as to how inaccurate our present guess is. But even *that* guess will be subject to surprises. I personally believe our stated reserves are adequate, but I've been wrong several times in the past.

The Annual Meeting

Our meeting this year will be held on Saturday, May 3rd. As always, the doors will open at the Qwest Center at 7 a.m., and a new Berkshire movie will be shown at 8:30. At 9:30 we will go directly to the question-and-answer period, which (with a break for lunch at the Qwest's stands) will last until 3:00. Then, after a short recess, Charlie and I will convene the annual meeting at 3:15. If you decide to leave during the day's question periods, please do so while *Charlie* is talking.

The best reason to exit, of course is to *shop*. We will help you do that by filling the 194,300-square-foot hall that adjoins the meeting area with the products of Berkshire subsidiaries. Last year, the 27,000 people who came to the meeting did their part, and almost every location racked up record sales. But you can do better. (If necessary, I'll lock the doors.)

This year we will again showcase a Clayton home (featuring Acme brick, Shaw carpet, Johns Manville insulation, MiTek fasteners, Carefree awnings and NFM furniture). You will find that this 1,550-square-foot home, priced at $69,500, delivers exceptional value. And after you purchase the house, consider also acquiring the Forest River RV and pontoon boat on display nearby.

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a special shareholder discount (usually 8%). This special offer is permitted by 45 of the 50 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least 50% of you, I believe we can.

On Saturday, at the Omaha airport, we will have the usual array of aircraft from NetJets available for your inspection. Stop by the NetJets booth at the Qwest to learn about viewing these planes. Come to Omaha by bus; leave in your new plane. And take all the hair gel and scissors that you wish on board with you.

Next, if you have any money left, visit the Bookworm, where you will find about 25 books and DVDs – all discounted – led again by *Poor Charlie's Almanack*. Without any advertising or bookstore placement, Charlie's book has now remarkably sold nearly 50,000 copies. For those of you who can't make the meeting, go to poorcharliesalmanack.com to order a copy.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. As for plane, hotel and car reservations, we have again signed up American Express (800-799-6634) to give you special help. Carol Pedersen, who handles these matters, does a terrific job for us each year, and I thank her for it. Hotel rooms can be hard to find, but work with Carol and you will get one.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. We initiated this special event at NFM eleven years ago, and sales during the "Weekend" grew from $5.3 million in 1997 to $30.9 million in 2007. This is more volume than most furniture stores register in a year.

To obtain the Berkshire discount, you must make your purchases between Thursday, May 1st and Monday, May 5th inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a Baja Beach Bash featuring beef and chicken tacos.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 10 p.m. on Friday, May 2nd. The second, the main gala, will be held on Sunday, May 4th, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 28th through Saturday, May 10th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder.

On Sunday, in a tent outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers. Additionally, we will have Bob Hamman and Sharon Osberg, two of the world's top bridge experts, available to play bridge with our shareholders on Sunday afternoon.

Gorat's will again be open exclusively for Berkshire shareholders on Sunday, May 4th, and will be serving from 4 p.m. until 10 p.m. Last year Gorat's, which seats 240, served 915 dinners on Shareholder Sunday. The three-day total was 2,487 including 656 T-bone steaks, the entrée preferred by the *cognoscenti*. Please remember that to come to Gorat's on that day, you must have a reservation. To make one, call 402-551-3733 on April 1st (*but not before*).

We will again have a reception at 4 p.m. on Saturday afternoon for shareholders who have come from outside of North America. Every year our meeting draws many people from around the globe, and Charlie and I want to be sure we personally greet those who have come so far. Last year we enjoyed meeting more than 400 of you from many dozens of countries. Any shareholder who comes from other than the U.S. or Canada will be given a special credential and instructions for attending this function.

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At 84 and 77, Charlie and I remain lucky beyond our dreams. We were born in America; had terrific parents who saw that we got good educations; have enjoyed wonderful families and great health; and came equipped with a "business" gene that allows us to prosper in a manner hugely disproportionate to that experienced by many people who contribute as much or more to our society's well-being. Moreover, we have long had jobs that we love, in which we are helped in countless ways by talented and cheerful associates. Every day is exciting to us; no wonder we tap-dance to work. But nothing is more fun for us than getting together with our shareholder-partners at Berkshire's annual meeting. So join us on May 3rd at the Qwest for our annual Woodstock for Capitalists. We'll see you there.

February 2008

Warren E. Buffett
Chairman of the Board