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March 14, 2006

***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 PACIFIC POWER & LIGHT Request for a  
General Rate Increase in the Company's Oregon Annual Revenues  
**Docket No. UE 170 (RECON)**

Dear Filing Center:

Enclosed please find the original and six (6) copies of the Direct Responsive Testimony of James Selecky for filing in the above-referenced proceeding on behalf of the Industrial Customers of Northwest Utilities.

Please return one file-stamped copy in the postage-prepaid envelope provided.  
Thank you for your assistance.

Sincerely,

*/s/ Christian Griffen*  
Christian W. Griffen

Enclosures  
cc: Service List

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Direct Responsive Testimony of James Selecky on behalf of the Industrial Customers of Northwest Utilities upon the parties on the service list by causing the same to be mailed, postage-prepaid, through the U.S. Mail.

Dated at Portland, Oregon, this 14th day of March, 2006.

/s/ Christian Griffen  
Christian W. Griffen

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**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON  
UE 170 (RECON)**

In the Matter of	)
	)
PACIFIC POWER & LIGHT	)
(dba PACIFICORP)	)
	)
Request for a General Rate Increase in the	)
<u>Company's Oregon Annual Revenues.</u>	)

**RESPONSIVE DIRECT TESTIMONY ON RECONSIDERATION OF  
JAMES SELECKY  
ON BEHALF OF  
THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES**

**March 14, 2006**

1   **Q.   PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2   **A.   James T. Selecky, 1215 Fern Ridge Parkway, Suite 208, St. Louis, MO 63141-2000.**

3   **Q.   WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?**

4   **A.   I am a consultant in the field of public utility regulation and a principal in the firm of**  
5       **Brubaker & Associates, Inc., energy, economic and regulatory consultants.**

6   **Q.   ARE YOU THE SAME JAMES SELECKY WHO PREVIOUSLY FILED DIRECT**  
7       **TESTIMONY AND SURREBUTTAL TESTIMONY IN THIS CASE?**

8   **A.   Yes.**

9   **Q.   WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

10   **A.   The purpose of my testimony is to comment on PacifiCorp's direct testimony in this**  
11       **Reconsideration phase of this proceeding. I will also discuss the treatment of income**  
12       **taxes for ratemaking purposes and the factual basis for PacifiCorp's deferred accounting**  
13       **request.**

14   **Q.   WHAT IS THE COMPANY'S PROPOSAL REGARDING THE LEVEL OF**  
15       **INCOME TAXES THAT SHOULD BE INCLUDED IN ITS REVENUE**  
16       **REQUIREMENT?**

17   **A.   PacifiCorp argues that the Company's stand-alone estimated tax liability should be**  
18       **included in the revenue requirement because the Company alleges that:**

- 19       •     Senate Bill ("SB") 408 is not applicable in this case and that SB 408 became  
20             effective after rates determined in this proceeding went into effect;
- 21       •     MidAmerican Energy Holdings Company's ("MEHC") proposed acquisition of  
22             PacifiCorp negates the basis of the tax adjustment;
- 23       •     If the Commission were to make a tax adjustment, an alternative methodology is  
24             more appropriate because it significantly lowers the adjustment to tax expense;

- 1       •     The tax adjustment will effectively preclude PacifiCorp from earning its 10%  
2             return on equity;
- 3       •     The tax adjustment will impair its credit rating and financial credit metric  
4             calculations; and
- 5       •     The implementation of SB 408 had a negative impact on the regulatory risk of  
6             operating in Oregon and will increase PacifiCorp's cost of capital.

7   **Q.   DOES THE COMPANY RAISE VALID ARGUMENTS IN SUPPORT OF**  
8   **REDUCING OR ELIMINATING THE TAX ADJUSTMENT FOUND**  
9   **APPROPRIATE BY THE COMMISSION?**

10 **A.**   No. As discussed below, the effective date of SB 408 does not limit or impair the just  
11       and reasonableness of the Commission's findings on the appropriate income tax expense  
12       to be included in PacifiCorp's revenue requirement. In addition, counsel has noted and  
13       argued at oral argument that SB 408 has a provision that shows the Legislature's policy  
14       that requires utility rates to only include taxes paid to units of government in order to be  
15       fair, just and reasonable. SB 408, Sections 2(f) and 5.

16       The MEHC acquisition of PacifiCorp may change the overall calculation of an  
17       appropriate tax expense, however, evidence indicates that MEHC's acquisition will not  
18       significantly change PacifiCorp's income tax liability that will actually be paid to taxing  
19       authorities. Therefore, the acquisition will likely not have a significant impact on the  
20       amount of tax expense appropriately included in PacifiCorp's revenue requirement.

21       The Company's evidence concerning the tax adjustment's impact on the return on  
22       equity earnings opportunity for PacifiCorp and calculation of the credit metrics and  
23       assessment of the credit quality are in error, or can be controlled by PacifiCorp's  
24       management and/or parent company structure. All this clearly indicates that PacifiCorp's

1 rates, and prudent and reasonable management activities that can preserve PacifiCorp's  
2 credit standing, provide its shareholders with fair compensation and allow PacifiCorp to  
3 recover income taxes that will ultimately be payable to government taxing authorities.

4 Finally, PacifiCorp has not provided any factual support that would allow the  
5 Commission to grant its deferred accounting request.

6 **Q. HOW DOES PACIFICORP PROPOSE TO TREAT THE LEVEL OF INCOME**  
7 **TAXES THAT ARE INCLUDED IN PACIFICORP'S REVENUE**  
8 **REQUIREMENT?**

9 **A.** The Company would utilize the stand-alone method to determine its income tax expense  
10 for ratemaking purposes. Under the stand-alone method, income tax expense for  
11 ratemaking is calculated based on the Commission's allowed level of revenue and  
12 expenses that are included in PacifiCorp's jurisdictional revenue requirement. As a  
13 result, the stand-alone method assumes that income taxes are paid to the taxing authority  
14 on an Oregon jurisdictional basis. The assumption is that the level of taxes included in  
15 rates represents an expense that PacifiCorp will realize if it earns its allowed rate of  
16 return.

17 **Q. DO THE INCOME TAXES THAT ARE CALCULATED ON A STAND-ALONE**  
18 **BASIS ACCURATELY REFLECT THE INCOME TAXES THAT PACIFICORP**  
19 **WILL PAY TO GOVERNMENTAL TAXING AUTHORITIES?**

20 **A.** No. The income taxes that are included in PacifiCorp's revenue requirement are not  
21 actual income taxes that PacifiCorp will pay because PacifiCorp does not pay its taxes on  
22 a stand-alone basis. Therefore, even if SB 408 did not apply, an adjustment to  
23 PacifiCorp's tax expense would be appropriate, to ensure the expense was fair, just and  
24 reasonable. The Commission recognized this in its Final Order in UE 170, and I



1 recommend that the Commission reaffirm that a tax adjustment should be made  
2 regardless of whether SB 408 applies.

3 **Q. HOW DOES PACIFICORP PAY ITS INCOME TAXES?**

4 **A.** PacifiCorp pays its income taxes as part of a consolidated tax return. Under the  
5 ScottishPower ownership, the federal and state income taxes were paid by PacifiCorp  
6 Holdings, Inc. ("PHI"), which is a non-operating, direct and wholly-owned subsidiary of  
7 the United Kingdom ("UK") Utility Holding Company, ScottishPower. Similarly, under  
8 the MEHC structure, the income taxes are paid by MEHC. Therefore, if the Commission  
9 determines that the pending acquisition of PacifiCorp by MEHC is a known and  
10 measurable change, this action should not eliminate the basis for making a tax adjustment  
11 to PacifiCorp's proposed revenue requirement. In addition, the tax adjustment should  
12 still be made, even if MEHC did not intend to file a consolidated tax return. The Final  
13 Order in UE 170 was issued in September, and the MEHC application is expected to be  
14 completed by the end of March. Thus, failure to make the tax adjustment would allow  
15 ScottishPower excessive, illegal earnings during its last six months of ownership of  
16 PacifiCorp.

17 **Q. IF SB 408 DID NOT APPLY IN THIS PROCEEDING, WOULD THE TAX**  
18 **ADJUSTMENT STILL BE APPROPRIATE?**

19 **A.** Yes. As noted above, the adjustment is intended to provide full recovery of the amount  
20 of income taxes attributable to PacifiCorp's taxable income that will ultimately be paid to  
21 government taxing authorities and to remove the amount of taxes that are not paid to  
22 units of government from PacifiCorp's revenue requirement. This objective is  
23 appropriate irrespective of whether SB 408 is applicable in the test year.

1 **Q. ONE OF THE QUESTIONS THAT THE COMMISSION ASKED IN**  
2 **ESTABLISHING THIS PROCEEDING WAS WHETHER THE COMMISSION**  
3 **WAS REQUIRED TO OR PROHIBITED FROM APPLYING SB 408 TO THIS**  
4 **DOCKET. WHAT IS YOUR OPINION REGARDING THE APPLICATION OF**  
5 **SB 408 TO THIS DOCKET?**

6 **A.** Although this may require a legal opinion, it is my position that SB 408 applies.  
7 Specifically, SB 408(2)(f) states the following:

8 Utility rates that include amounts for taxes should reflect the taxes that are  
9 paid to units of government to be considered fair, just and reasonable.

10 SB 408 also amended ORS § 757.210 to state that the Commission “may not  
11 authorize a rate or schedule of rates that is not fair, just and reasonable.” SB 408, Section  
12 5. This requirement of ORS § 757.210 applies to any utility rate that the Commission  
13 may approve, and the changes to this statute became effective immediately upon the  
14 passage of SB 408. Based on the definition of fair, just and reasonable rates in section  
15 2(f) of SB 408, the Commission is required to follow the Legislature’s policy that fair,  
16 just and reasonable rates that are authorized after the passage of SB 408 may not include  
17 taxes that are never paid to units of government.

18 To establish a fair, just and reasonable level of income taxes to be included in the  
19 utility’s revenue requirement, the Commission cannot ignore the amount and manner in  
20 which a utility pays its income taxes. PacifiCorp pays its income taxes on a consolidated  
21 basis and its rates should reflect this fact.

22 **Q. WHY DO YOU THINK IT IS APPROPRIATE FOR PACIFICORP’S**  
23 **RATEPAYERS TO BENEFIT FROM AFFILIATE TAX DEDUCTIONS WHEN**  
24 **THEY DO NOT HAVE ANY OF THE COST INCLUDED IN THEIR RATES?**

25 **A.** First, by not reflecting actual taxes paid as opposed to utilizing hypothetical taxes paid,  
26 the Commission is in essence asking PacifiCorp’s ratepayers to subsidize ScottishPower  
27 or MEHC’s shareholders. The amount of income tax expense recovered from PacifiCorp

1 in excess of the amount of tax expense paid to governmental taxing authorities is retained  
2 in the consolidated corporate income and will enhance ScottishPower's earned return on  
3 its investment in PacifiCorp. In other words, ScottishPower will be provided an  
4 opportunity to earn more than the 10% return on equity found appropriate by the  
5 Commission in this proceeding. This is inherently unfair, unjust and unreasonable.

6 Second, it is not consistent with sound regulatory principles to have ratepayers'  
7 rates include a cost that will not be incurred by the Company. For example, the  
8 Commission would not allow PacifiCorp to include in its rates an O&M expense if it  
9 knew the Company would not actually incur this expense. In this instance, the expense  
10 does not provide any service to ratepayers, and would be viewed as being not used or  
11 useful. This would result in the expense being disallowed for ratemaking purposes. This  
12 concept applies to the tax obligation that is included in rates.

13 Third, including a tax expense in rates that the Company does not incur will  
14 provide enhancement to PacifiCorp's shareholders. If the expense does not occur, the  
15 additional revenues will provide additional return for PacifiCorp's shareholders.  
16 Therefore, the rates would not be just and reasonable.

1 **Q. MR. MARTIN INDICATES ON PAGE 2 OF HIS TESTIMONY (PPL/1303) THAT**  
2 **SB 408 CREATES AN AUTOMATIC ADJUSTMENT CLAUSE TO TRUE-UP**  
3 **TAXES COLLECTED IN RATES AFTER JANUARY 1, 2006 TO ACTUAL**  
4 **TAXES PAID TO UNITS OF GOVERNMENT. HE ARGUES THAT IT DOES**  
5 **NOT PURPORT TO ADDRESS THE CALCULATION OF TAX EXPENSE IN**  
6 **BASE RATES AND DOES NOT APPLY TO UE 170, A CASE THAT RESULTED**  
7 **IN RATES EFFECTIVE IN 2005. SHOULD THE COMMISSION REFLECT AN**  
8 **ESTIMATE OF TAXES PAID IN DEVELOPING PACIFICORP'S RATES?**

9 **A.** Yes. As indicated in the testimony of Doug Larson, UE 170 is based upon a 2006  
10 calendar year test year. PPL/1702, Larson/3, line 18. Therefore, the development of  
11 PacifiCorp's revenue requirement should reflect the actual tax paid as opposed to an  
12 artificially high amount.

13 **Q. MR. MARTIN INDICATES IN HIS TESTIMONY THAT IF AN ADJUSTMENT**  
14 **IS MADE TO PACIFICORP'S REVENUE REQUIREMENT RELATED TO ITS**  
15 **SCOTTISHPOWER OWNERSHIP, THAT ADJUSTMENT SHOULD ONLY BE**  
16 **\$2.6 MILLION, NOT THE \$26.6 MILLION THAT THE COMMISSION**  
17 **AUTHORIZED. PLEASE SUMMARIZE MR. MARTIN'S CALCULATION AS**  
18 **SHOWN ON PAGE 7 OF HIS TESTIMONY.**

19 **A.** To develop his recommended \$2.6 million tax adjustment on a grossed-up basis, Mr.  
20 Martin relies on a lower PHI interest deduction than utilized by the Commission in its  
21 order, a lower Oregon allocation factor, and the inclusion of a UK tax.

22 **Q. IS MR. MARTIN'S CALCULATION, AS SHOWN ON PAGE 7 OF HIS**  
23 **TESTIMONY, REASONABLE?**

24 **A.** No. First, regarding the PHI interest rate, Mr. Martin contends that the interest rate on  
25 the current debt is 4.97688%. PPL/1303, Martin/6. However, information provided in  
26 UE 170 clearly indicated that the interest rate on the PHI debt was 6.75%. ICNU/402,  
27 Gorman/12. Since I am not aware of any information that PacifiCorp provided that  
28 substantiated the lowering of the interest rate, the Commission should continue to utilize  
29 the interest rate provided for in the Commission's order in this proceeding. In addition, if

1 this interest rate did change after the close of the record in UE 170, it would be  
2 inappropriate to change it for the tax reconsideration.

3 Second, Mr. Martin has included in his calculation an adjustment that reflects the  
4 taxes that ScottishPower now pays on the PHI interest payments as a result of the passage  
5 of the UK Finance Act of 2005. The taxes that ScottishPower pays to the UK on the PHI  
6 interest should not be included in the development of PacifiCorp's revenue requirement.  
7 The Commission has not included taxes that other bondholders pay on interest they  
8 receive on utility bonds in the development of a utility's revenue requirement. In other  
9 words, this would be like grossing up, for income taxes, the Company's embedded debt  
10 cost in developing its overall rate of return and income tax expense. However, the  
11 Company's own filing does not reflect this flawed adjustment. Indeed, the Company  
12 properly reflects its debt interest expense as a deduction in the calculation of its income  
13 tax. Mr. Martin proposes to essentially ignore tax deductibility of PHI's interest  
14 payments to ScottishPower in the calculation of income tax applicable to PacifiCorp's  
15 income, which is in direct contradiction of the treatment of other PacifiCorp debt interest,  
16 and the traditional regulatory treatment of interest and tax expense. In fact, I am not  
17 aware of a single commission that reflects bondholders' tax rates in the development of a  
18 utility's total revenue requirement. ScottishPower, which is the holder of the bond,  
19 should not be treated any differently than any other bondholder. Therefore, including a  
20 30% tax factor to reduce the tax component of PacifiCorp's revenue requirement is  
21 unprecedented and entirely inappropriate.

22 Third, PacifiCorp argues that the allocation of interest that is utilized to develop  
23 the tax deduction should be based on relative taxable income. In the Commission's Final

1 Order in this case, the allocation was based on gross profits to the PHI affiliated group. I  
2 reject Mr. Martin's allocation proposal and continue to support the allocation of PHI's  
3 interest on the basis of assets. Debt is a liability that supports the assets of a company.  
4 Hence, PHI's debt supports its assets. Therefore, PHI's debt and debt interest is properly  
5 allocated among PHI on the basis of its assets. The Company indicated that 94.72% of  
6 the net book value listed in the consolidated tax return is attributable to PacifiCorp.

7 Finally, cost of service studies that are utilized to set rates allocate the interest to  
8 the various rate classes based on assets – not profitability of a class and/or taxable  
9 income. This is the procedure that commissions have been utilizing for years to allocate  
10 interest expense for ratemaking purposes to the various customer classes. This same  
11 procedure should also be utilized to allocate this interest expense to the various  
12 subsidiaries of ScottishPower. Therefore, for these reasons I continue to support an  
13 allocation which is based on investment.

14 **Q. IF THE COMMISSION RECOGNIZES THE MEHC ACQUISITION OF**  
15 **PACIFICORP AS A KNOWN AND MEASURABLE CHANGE, DOES THAT**  
16 **ELIMINATE THE NEED FOR THE TAX ADJUSTMENT?**

17 **A.** No. As I have previously indicated, PacifiCorp does not file income taxes on a stand-  
18 alone basis, but files taxes on a consolidated basis. As indicated in MEHC's quarterly  
19 SEC Form 10-Q, in March 2005, MEHC's capital structure contained approximately  
20 78.3% debt and 21.0% common equity. This leveraged capital structure provides MEHC  
21 on a consolidated basis with a significant interest deduction similar to what PHI utilized  
22 to determine its consolidated income taxes.

23 Including the PHI debt of \$2.375 billion in PacifiCorp's capital structure produces  
24 a debt ratio of approximately 63%. This is less than the debt ratio of MEHC.

1 **Q. DID PACIFICORP WITNESS WILLIAMS HAVE SOME COMMENTS**  
2 **CONCERNING PACIFICORP'S EARNED RETURN OPPORTUNITY BASED**  
3 **ON THE RATES ADOPTED IN THE RATE ORDER IN OREGON?**

4 **A.** Yes. Relying on PacifiCorp witness Martin's testimony, he argues that PacifiCorp will  
5 incur tax expense that it will not recover in rates. As a result, Mr. Williams asserts that  
6 PacifiCorp's rates will provide it with an opportunity to earn a return on common equity  
7 of 8.4% instead of the 10.0% return approved by the Commission. He asserts that an  
8 8.4% return on equity is low in comparison to the U.S. electric industry average earned  
9 return on equity and is not a fair risk compensatory return.

10 **Q. DO MR. WILLIAMS' ARGUMENTS CONCERNING PACIFICORP'S EARN-**  
11 **INGS ENTITLEMENT UNDER THE OREGON RATE ORDER HAVE MERIT?**

12 **A.** No. The Final Order in UE 170 set a rate of return commensurate with the return on  
13 investments in other enterprises having similar risks, and was sufficient to ensure  
14 confidence in the Company's financial integrity as to allow PacifiCorp to attract capital  
15 and maintain its credit rating. Significantly, after the Commission's Final Order, MEHC  
16 continued its efforts to purchase PacifiCorp, is expected to acquire PacifiCorp later this  
17 month, and is committed to investing significant amounts of capital into PacifiCorp. This  
18 demonstrates that PacifiCorp's claims regarding its earnings and credit are overblown  
19 and inaccurate.

20 As noted above, the adjustment to PacifiCorp's income tax expense is designed to  
21 remove tax expenses from the revenue requirement that will not ultimately be paid to  
22 government taxing authorities. To the extent PacifiCorp makes tax payments to PHI that  
23 are greater than the tax expense ultimately paid to taxing authorities on PacifiCorp's  
24 earnings, then PacifiCorp's owner, PHI, will be driving down PacifiCorp's earnings  
25 below 10% by charging PacifiCorp an inflated tax expense. The depressed earnings

1 would not be the result of the rate setting standards in Oregon. It is also worth noting that  
2 the 10% ROE was the result of a settlement in UE 170.

3 Further, Mr. Williams has not established that PacifiCorp would be required to  
4 remit tax payments to PHI if those tax payments are not ultimately payable to taxing  
5 authorities. If PacifiCorp is allowed to retain its after-tax earnings entitlement and only  
6 remit legitimate income tax expenses to its parent company, then its after-tax earnings  
7 entitlement would be 10%, not 8.4%.

8 **Q. MR. WILLIAMS ALSO ARGUES THAT AN 8.4% RETURN ON EQUITY IS**  
9 **NOT COMMENSURATE WITH RETURNS ON INVESTMENTS IN OTHER**  
10 **ENTERPRISES OF CORRESPONDING RISK. PLEASE COMMENT.**

11 **A.** This testimony is a red herring. PacifiCorp's rates are set to provide it with an  
12 opportunity to earn a return on equity of 10%, not 8.4%. A 10% return on equity is risk  
13 compensatory and fair, as the Commission found in approving the return on equity  
14 settlement.

15 **Q. MR. WILLIAMS ALSO ARGUES THAT A REDUCTION IN RECOVERABLE**  
16 **TAX EXPENSE WILL ERODE PACIFICORP'S CREDIT RATING FINANCIAL**  
17 **METRIC CALCULATIONS AND POSSIBLY LEAD TO A CREDIT RATING**  
18 **DOWNGRADE. HAS MR. WILLIAMS ACCURATELY ASSESSED PACIFI-**  
19 **CORP'S CREDIT RATING FINANCIAL METRICS UNDER THE APPROVED**  
20 **RATES?**

21 **A.** No. Mr. Williams' calculations are based on his assumption that the approved rates will  
22 provide PacifiCorp an opportunity to earn an 8.4% return on equity, not the 10.0%  
23 approved in the rate order. This is an inaccurate assessment. Updating Mr. Williams'  
24 credit ratio analysis, using the 10% return on equity approved in the rate order,  
25 demonstrates that PacifiCorp's credit rating financial metrics will be adequate to support  
26 its "A-" corporate bond rating and a strong "BBB+" unsecured bond rating, which are  
27 PacifiCorp's current bond ratings.



**Q. HAVE YOU REVISED MR. WILLIAMS' FINANCIAL METRICS TO ASSESS PACIFICORP'S CREDIT METRIC FINANCIAL RATIOS FOR BOTH TOTAL AND CORPORATE DEBT OBLIGATIONS?**

**A.** Yes. This is shown below in Table 1. In this analysis, I updated Mr. Williams' credit metric calculations, but used a 10% return on equity rather than the 8.4% return used by Mr. Williams.

<b>TABLE 1</b> <b><u>Credit Rating Financial Metrics</u></b>				
<u>S&amp;P Key Credit Ratios</u>	<u>PacifiCorp</u>	<u>S&amp;P Guidelines</u>		
	<u>S&amp;P Ratios</u>	<u>A-Rated Business Profile "5"</u>	<u>BBB-Rated Business Profile "5"</u>	<u>Ratings Prognosis</u>
FFO Interest Coverage	3.8x	4.5x - 3.8x	2.8x - 3.8x	Low A
Total Debt to Total Capital	56.1%	42% - 50%	50% - 60%	Mid BBB
FFO to Total Debt	18.3%	30% - 22%	15% - 22%	Mid BBB

As shown above in Table 1, credit metrics based on PacifiCorp's total financial obligations, including \$570 million of off-balance sheet debt equivalents, indicate a weak "A" rating to strong "BBB" credit rating, based on all three credit measures.

Specifically, PacifiCorp's funds from operations ("FFO") interest coverage ratio is 3.8x, which is at the bottom of an "A" rating category. PacifiCorp's total debt to total capitalization ratio of 56% is the midpoint of a "BBB" rating, and FFO to total debt coverage of 18.3% is also at the midpoint of the "BBB" rating.

**Q. HOW WOULD THE FINANCIAL METRICS LOOK IF THEY ARE MADE IN COMPARISON ONLY TO PACIFICORP'S CORPORATE FINANCIAL OBLIGATIONS?**

**A.** This assessment is much more complicated, but simply excluding the off-balance sheet debt equivalents will have a significant improvement to the credit metric calculations and clearly indicates that the Final Order's authorized return on equity and capital structure will support PacifiCorp's "A-" corporate credit rating. This is shown below in Table 2. In Table 2, I have excluded the off-balance sheet debt equivalence, which are junior unsubordinated debt obligations of PacifiCorp and are properly excluded from an analysis to show the strength of PacifiCorp's cash flow coverage of corporate debt obligations.

As shown in Table 2, PacifiCorp's FFO interest coverage ratio increases to a strong "A" and its total debt to total capital and FFO to total debt both improve to strong "BBB" levels.

<b>TABLE 2</b>				
<b><u>Credit Rating Financial Metrics Excluding Off-Balance Sheet</u></b>				
<u>S&amp;P Key Credit Ratios</u>	<u>PacifiCorp S&amp;P Ratios</u>	<u>S&amp;P Guidelines</u>		
		<u>A-Rated Business Profile "5"</u>	<u>BBB-Rated Business Profile "5"</u>	<u>Ratings Prognosis</u>
FFO Interest Coverage	4.3x	4.5x - 3.8x	2.8x - 3.8x	High A
Total Debt to Total Capital	53%	42% - 50%	50% - 60%	High BBB
FFO to Total Debt	21%	30% - 22%	15% - 22%	High BBB

These ratios illustrate that the Final Order's return on equity and capital structure will support PacifiCorp's current "A-" corporate credit rating.

1 **Q. MR. WILLIAMS ALSO REFERENCES RECENT CREDIT RATING REPORTS**  
2 **FROM FITCH, STANDARD & POOR'S ("S&P") AND CONVERSATIONS**  
3 **WITH BANKING INSTITUTIONS THAT STATE CREDIT CONCERNS FOR**  
4 **THE IMPLEMENTATION OF SB 408 AND RECENT TAX EXPENSE**  
5 **ADJUSTMENTS. PLEASE COMMENT.**

6 **A.** Both Fitch and S&P state concerns about SB 408 and tax treatments' resulting financial  
7 impact on PacifiCorp. Ultimately, the impact on PacifiCorp will be determined based on  
8 how PacifiCorp's immediate parent company, PHI, will withdraw funds from PacifiCorp.  
9 Specifically, if PacifiCorp pays tax expense to PHI, irrespective of whether that expense  
10 will ultimately be paid to government taxing authorities, then PacifiCorp's cash flows  
11 could be negatively impacted, which could impact its credit standing. Conversely, if PHI  
12 only draws tax expense from PacifiCorp in line with PHI's actual tax payments to  
13 governmental authorities, which is consistent with the rate treatment awarded, then  
14 PacifiCorp's cash flow and credit metrics will not be impacted. Hence, PacifiCorp's  
15 credit metrics will be as described in Tables 1 and 2 above, which support PacifiCorp's  
16 current corporate and unsecured credit ratings.

17 What is clear is that PacifiCorp's immediate parent company will control the  
18 financial impact on PacifiCorp, as PacifiCorp is allowed to collect tax expenses from  
19 customers that will ultimately be paid to taxing authorities. It is only under the  
20 circumstances where the affiliate requires PacifiCorp to remit tax payments that exceed  
21 the actual tax payments to governmental taxing authorities that there may be a  
22 detrimental impact on PacifiCorp's financial credit metrics and credit rating. Therefore,  
23 the impact on PacifiCorp's credit standing is largely within the control of PacifiCorp and  
24 ScottishPower's management. The same relationship would exist under PacifiCorp  
25 ownership by MEHC.

1 **Q. MR. WILLIAMS ALSO NOTES THAT REGULATORY RESEARCH REDUCED**  
2 **THE REGULATORY ENVIRONMENT RATING OF OREGON FROM**  
3 **AVERAGE/1 DOWN TO AVERAGE/2 WITH POTENTIAL NEGATIVE**  
4 **RAMIFICATIONS OF SB 408. PLEASE COMMENT.**

5 **A.** Regulatory Research Associates (“RRR”) state regulatory evaluations reduced Oregon’s  
6 ratings from A-Average/1 to A-Average/2. While this was a reduction to its regulatory  
7 ranking, apparently in response to its concern about consolidated tax savings required  
8 under SB 408, it nevertheless leaves Oregon’s overall regulatory ranking at a level that is  
9 generally consistent with the “middle of the pack,” or typical jurisdictional regulatory  
10 ranking.

11 A high regulatory ranking generally indicates that regulators set rates in favor of  
12 investors. For example, the report states that California’s ranking increased because the  
13 California Regulatory Commission awarded utilities high returns on equity. The ranking  
14 is lowered if the regulators set rates that provide more consideration to the concerns of  
15 customers. Having a regulatory ranking in the middle indicates Oregon’s balanced  
16 consideration of the interests of both investors and ratepayers.

17 **Q. IS IT APPROPRIATE TO UTILIZE DEFERRED ACCOUNTING AS A REMEDY**  
18 **IN THIS PROCEEDING?**

19  
20 **A.** No. ICNU’s legal briefing will explain why PacifiCorp’s request to use the deferred  
21 accounting statute is an illegal challenge to a lawful Commission order and is  
22 inconsistent with the Commission’s standards regarding deferrals. However, I find that  
23 PacifiCorp has failed to present factual evidence that would establish that its deferred  
24 accounting request is consistent with any of the criteria established in ORS § 757.259(2)  
25 regarding the types of monies the Commission can defer.

1           First, PacifiCorp is utilizing the deferred accounting statute to defer costs when  
2 seeking reconsideration of a Commission order. The primary purpose of PacifiCorp's  
3 request is to defer costs the Commission previously determined could not be included in  
4 rates. This is not a proper basis upon which a deferred accounting request should be  
5 granted.

6           Second, there is no credible evidence that granting the deferral request would  
7 minimize the frequency of rate changes or fluctuations. PacifiCorp has not submitted  
8 evidence demonstrating what realistic options for rate filings it considered prior to filing  
9 its deferral request, or whether the Company would be factually or legally entitled to any  
10 such rate relief. Given that PacifiCorp has already filed a new Oregon general rate case,  
11 it is hard to imagine that granting the deferred accounting request could reduce the  
12 frequency of rate changes or fluctuations that customers are already experiencing.

13           Third, granting PacifiCorp's deferred accounting request will not match the costs  
14 borne by and the benefits received by ratepayers. The costs PacifiCorp is seeking to  
15 defer will not have long-term benefits, thus, any costs borne by future customers will not  
16 be matched with any future benefits. Recognizing this, PacifiCorp has simply asserted  
17 that costs and benefits will be matched because its tax costs are allegedly related to  
18 providing electric service to customers. As demonstrated above, this is false because the  
19 tax costs are not costs the Company actually incurs and they are not related to providing  
20 any service to customers. This is also irrelevant because, to charge a cost to ratepayers,  
21 all costs must be related to providing electric service to customers. Allowing a utility to  
22 defer costs because they are related to providing electric service would mean that a utility  
23 could essentially defer any utility related costs it wishes.

1   **Q.     WHAT IS YOUR RECOMMENDATION IN THIS CASE?**

2   **A.**    My recommendation in this case is that the Commission should continue to reflect the tax  
3           adjustment in PacifiCorp's revenue requirement. The Commission appropriately found  
4           that SB 408's principles should apply to UE 170. The Commission correctly applied the  
5           principle that PacifiCorp's rates should only include taxes paid to units of government. It  
6           would have been appropriate for the Commission to have adopted either ICNU's, CUB's,  
7           or its own modified tax adjustment to ensure that taxes not paid to the government were  
8           excluded from rates. The tax adjustment adopted by the Commission was consistent with  
9           SB 408's principles and all of the evidence in this proceeding and should not be changed.  
10          Finally, the taxes that are included in the revenue requirement can be trued-up to the  
11          actual taxes paid as required by SB 408.

12   **Q.     DOES THIS CONCLUDE YOUR TESTIMONY?**

13   **A.**    Yes.