**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

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| **IN THE MATTER OF THE APPLICATION OF PACIFICORP DBA UTAH POWER & LIGHT COMPANY FOR APPROVAL OF CHANGES TO ITS ELECTRIC SERVICE SCHEDULES** | ) CASE NO. PAC-E-05-1<br>)<br>) Direct Testimony of Daniel J. Rosborough<br>)<br>) |

**PACIFICORP**

**CASE NO. PAC-E-05-1**

**January 2005**

**Q. Please state your name, business address and present position with PacifiCorp (the Company).**

A. My name is Daniel J. Rosborough. My business address is 825 N.E. Multnomah, Suite 1800, Portland, Oregon 97232. My present position is Director of Employee Benefits.

**Qualifications**

**Q. Briefly describe your education and business experience.**

A. I have been employed by PacifiCorp for 22 years and I have served as the Director of Benefits for approximately 12 years. I attended Lane Community College and the University of Oregon.

**Q. Please describe your current duties.**

A. My responsibilities include the analysis, design, administration and compliance of the Company's heath and welfare and retirement programs.

**Purpose of Testimony**

**Q. What is the purpose of your testimony?**

A. My testimony addresses the Company's pension and welfare benefit costs. All costs are presented on a system-wide basis. In the first section of my testimony, I will describe two types of PacifiCorp's pension costs the Company is seeking to recover in this case. The Company proposes to recover in base rates $48.5 million in annualized pension costs for PacifiCorp's defined benefit pension plan. The Company is also seeking to recover in base rates $3.0 million in pension expense associated with a contribution for the significant majority of employees of PacifiCorp represented by the International Brotherhood of Electrical Workers

("IBEW") Local 57. This is a separate pension plan negotiated with the IBEW. In the second section of my testimony, I describe the Company's proposal to recover in rates $110.4 million in medical, dental and other benefit coverage costs and explain the major reasons for the increase in those costs. I also describe the actions the Company is taking to control those costs.

**Pension Expense**

**Q. Who actually participates in the company retirement plans?**

A. As of January 1, 2004, the PacifiCorp Retirement Plan has approximately 4,150 active participants and the Local 57 plan approximately another 1,460. Of this total of 5,610 participants, approximately 200 (4 percent) reside and work in the state of Idaho.

**<u>Defined Benefit Pension Plan Expense</u>**

**Q. What is the plan's current funding status?**

A. The plan is currently underfunded. This situation exists for two primary reasons: unusually low interest rates (which means the current valuation of liabilities is artificially high, thereby increasing the amount of "expense" that is required to cover the cost of the Plan); and poor investment returns over the 2000 – 2002 period when most investment markets have performed poorly. Strong investment performance in 2003 and significant cash contributions (the Company contributed $61 million in April of 2004) have stabilized and actually improved the funded status over the past 18 months. As of January 1, 2004, the plan's funded status was approximately 70 percent.

**Q. How is the Company's pension expense determined?**

A. The expense for the plan is determined annually by an independent actuary, Hewitt Associates, as prescribed by the Financial Accounting Standards Board through its accounting standard governing the calculation of pension expense (SFAS 87). Under SFAS 87, the pension expense amount is calculated by the actuary based upon the actual demographics of the participants in the plan, the expected benefits to be paid, expected terminations and retirements, expected pay raises, current interest rates for valuing the plan's liabilities, and a forecast of the expected long-term rate of return on plan assets. Pension expense is calculated by the actuary on a calendar year basis but SFAS 87 permits this calculation to be used by companies utilizing a different fiscal year, such as PacifiCorp, provided the fiscal year end is no more than three months divergent from the calendar year. To the extent that actual investment returns and other experience with the plan differ from the expectations, these differences are amortized into future expense once they exceed a certain threshold.

**Q. What is the level of pension expense included in the Company's request?**

A. The Company is seeking to recover $48.5 million in expected pension expense. This is the amount of pension expense the Company expects to incur in FY 2006 (fiscal year 2006 ends March 31, 2006). The amount is based on actual FY 2005 expense of $31.5 million which was a SFAS 87 actuarial calculation conducted by the Company's actuary, Hewitt Associates. This calculation is included in the actuarial report which is provided as Exhibit No. 13. The FY 2006 calculation was developed using the actual 2005 expense as a baseline and incorporated an expected actual investment return of 4 percent for calendar year 2004 (because the actual calendar year through May 2004 was essentially zero to 1 percent positive and 8 percent for 2005. The calculation also included an expected decrease in the discount rate used to value the plan's liabilities from 6.25 percent, which is the discount rate used in the FY 2005 calculations, to 6.00 percent. Page 1 of Exhibit No. 14 explains the allocation of FY 2004 and FY 2005 pension expense and page 2 of Exhibit No. 14 provides a reconciliation of projected FY 2006 pension expense to actual FY 2005 pension expense. Both pages of this exhibit were prepared by Hewitt Associates. The filing also requests recovery of $3.0 million in pension expense related to contributions to the Local 57 Retirement Plan that the Company intends to make in February of 2006.

**Q. Why is the expected cost rising so dramatically?**

A. The PacifiCorp Retirement Plan expense increased dramatically from FY 2004 ($14.8M) to FY 2005 ($31.5M) and is expected to increase dramatically again in FY 2006 ($48.5M). The average increase between 2003 through 2006 is $23.8 million per year. This is primarily due to investment losses which occurred between 2000 and 2002 and discount rates that have now remained at historic lows for several years. During those three years, the Plan experienced $450 million of asset losses (the difference between actual investment loss and the amount of gain assumed by the actuary). Reflecting those losses has an obvious and significant impact on pension expense. However, because we spread those losses over the succeeding five years (spreading losses and gains to mitigate volatility is allowed under SFAS 87 and is a common spread practice among large pension plans), the resulting increase in pension expense is smoothed over the period. Thus, what could be a really dramatic increase in pension expense is smoothed. But that also means that those losses continue to build into the succeeding years' pension expense until each year is fully amortized, so it will take until 2007 or 2008 for them to be fully recognized. The expense pattern for the Local 57 Retirement Plan has been more steady and actually declined since it reached $5.65M in FY 2004. We expect that the need for continuing contributions will not reach FY 2004 levels for several years.

Q. **Are the pension plans of other utilities impacted by the same economic conditions?**

A. Yes. PacifiCorp is no different than other utilities, or plan sponsors in other industries for that matter. Trust fund investments over the 2000 - 2002 period performed poorly for almost every large fund, and interest rate declines inflate the liabilities of all pension plans. Investment returns were strong in 2003 which helped asset growth, but interest rates remained very low, if not lower than in 2002, which means that liabilities of plans stayed very high.

Q. **What does the Company expect to happen to pension expense after FY 2006?**

A. Using the same baseline data utilized in the FY 2006 analysis, we expect pension expense for the PacifiCorp plan to increase to $48.9 million in FY 2007. This analysis is based on an expected actual 8 percent asset return for 2006 and an increase in the discount rate to 6.25 percent.

**Q. Is the plan underfunded due to the Company offering benefits that are more generous than those of other comparable utility companies?**

A. No. The Company retains Hewitt Associates to conduct a comparison of its benefit programs to those of other utilities every other year to ensure competitiveness. The last such survey was done in mid-2002 and showed the PacifiCorp Retirement Plan to be comparable to the average defined benefit plan value of other surveyed utilities. Attached as Exhibit No. 15 is an introduction to the survey results and the page related to the evaluation of the defined benefit plan. As the survey shows, PacifiCorp's defined benefit plan is within 2 percent of the value of the average of all other plans included in the survey group.

**Q. Who oversees the money that is contributed to the Company's pension plan?**

A. The Company has appointed a Committee (PacifiCorp Pension Investment Committee) that has a fiduciary responsibility to oversee the prudence of the investment of those assets and determine the asset allocation investment strategy. All plan assets are held in a trust and those assets can only be used for the benefit of plan participants. PacifiCorp's Committee has retained outside consultants to assist in this function and has delegated the actual investment responsibility to outside professional investment managers. The plan assets are broadly diversified across asset classes and investment managers. Relative to comparable corporate plans, over the last five years the PacifiCorp plan's investment returns have been above those of the median peer plan.

**IBEW 57 Pension Expense**

**Q. Please describe the IBEW 57 pension expense.**

A. The Company contribution for this expense is subject to the collective bargaining process. In accordance with that process, the Company made a $5 million contribution in 2003 and $5.6 million contribution in 2004 and intends to make a $2.0 million contribution in February 2005. As in the case of the Company's Retirement Plan, the Company proposes to include in rates the budgeted contribution of $3.0 million for FY 2006. The reason for the lower test period contribution (relative to 2003 and 2004 levels) is that the plan's investment return was favorable in 2003 and the necessity of additional cash contributions has lessened. When the plan was first established pursuant to collective bargaining in 1998-1999, the union and the Company agreed that the Company would contribute 7 percent of eligible pay to the plan, but that favorable investment returns would be recognized as lessening the need for contributions at that agreed upon level.

**Q. Why is this pension expense separate from the defined benefit plan expense discussed above?**

A. Simply because it is a separate plan. The Local 57 plan was negotiated in 1998/1999 and effective July 1, 1999. PacifiCorp is not the plan sponsor but is contractually obligated through the collective bargaining process to make contributions on the behalf of employees represented by Local 57 (who work in Idaho, Utah and Wyoming) and eligible to participate. Prior benefits earned by these same employees, and assets to pay the benefits, were transferred to this new plan in 2001 and those benefits are now the obligation of that Trust and not the obligation of the PacifiCorp Retirement Plan.

The Trustees of the PacifiCorp/IBEW Local 57 Retirement Trust now manage these assets. There are four Trustees from PacifiCorp management and four from Local 57 IBEW leadership. The Trust employs professional actuarial consultants, administrators, an attorney, an auditor and investment managers. PacifiCorp provides funding to the plan based upon a collectively bargained agreement and annual negotiations.

**Medical, Dental and Other Benefit Coverage Costs**

**Q. What level of medical, dental and other benefit costs are included in the Company's revenue requirement in this case?**

A. The Company expects to record $110.4 million in FY 2006 for medical, dental and other benefit costs that it expects to incur. This represents an increase of $9.3 million over the equivalent FY 2005 expense of $101.1 million. These amounts exclude costs associated with the Supplemental Executive Retirement Plan.

**Q. Please explain the reasons for the increase in these costs.**

A. The increase in medical coverage costs is the primary reason for the increase in these costs. PacifiCorp's health plans, like almost every other health plan in the United States, have been experiencing significant increases in medical inflation. The primary drivers behind the increases are:

- A lesser degree of effectiveness of managed care plans. It is widely believed that after several years of successful negotiations with providers to minimize annual cost increases, the "market" has now turned and providers are being more successful at negotiating increases with managed care networks;

- Government mandates and continued cost shifting by government plans to the private sector;
- An aging population;
- The cost of prescription drugs, compounded by very effective direct consumer marketing;
- Increased prevalence of chronic and high cost treatment; and
- Development and expansion of new medical technology.

Q. **How do the medical cost increases that PacifiCorp has been experiencing relate to the cost increases being experienced by other employers?**

A. Over the past several years, PacifiCorp's record with respect to cost increases in medical plans compared favorably to that of other employers. Exhibit No. 16 outlines the recent history of increases for PacifiCorp's primary health plans relative to how a similar set of plans would have fared using national medical inflation experience. As the exhibit demonstrates, PacifiCorp's plans have performed better than the average plan experience. As illustrated in Exhibit No. 16, PacifiCorp's electric operations group has experienced a five-year increase of 55.5 percent in medical costs while the national average for the same types of plans have increased by 66.8 percent.

Q. **Has PacifiCorp made any changes to its medical programs or practices to try to mitigate the cost increases?**

A. Yes. Over the past few years, a number of changes have been incorporated into the PacifiCorp plan design to attempt to mitigate cost increases, including:

- Implementation of a mail order prescription drug program. These programs have proven effective at slowing the increases in this area, which for most plans has been the most difficult cost challenge.
- Expansion of geographic locations offering managed care plans. In areas where a managed care plan can be supported, the Company has expanded these offerings accordingly.
- The plan has for several years included a fully paid physical exam benefit for covered individuals. In order to continue to emphasize long term cost savings and improved health through a "preventive medicine" approach, this benefit was slightly improved in 2003.
- The Company has continually expanded the educational materials and resources for plan participants in order to make them better consumers of the plan and better able to utilize plan benefits. Included in this arena are access to a 24 hour Nurse Advice Line, an on-line health risk assessment tool and access to specialty programs for transplants and other high costs claim areas.
- Employee cost sharing has steadily increased over the past several years through increases to annual out of pocket limits. During 2004, the company paid 91 percent of the total plan cost and employees paid 9 percent. This will be adjusted again in 2005 so that employees will be paying 10 percent of the monthly cost of the plan.
- Elimination of the $100 deductible medical plan. This plan option was the least cost effective plan offered by PacifiCorp and is being eliminated in 2005.
- Implementation of a Consumer Driven Health Plan and a Disease

- Management program. These plans are anticipated to be instrumental in controlling the long term cost challenges of our programs.
- In 2004, the Company implemented changes to the prescription drug program to increase the employee's cost sharing and further encourage the use of generic drugs.

Exhibit No. 17 provides a summary of survey results for the Company's health care programs, conducted in 2002 by Hewitt Associates. This survey data demonstrates that PacifiCorp's plans are comparable to those offered by other electric utilities.

**Q. Does this conclude your direct testimony?**

A. Yes.