BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

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)) Direct Testimony of John W. Stewart))

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 John W. Stewart, and my business address is One Utah Center, Suite 2300, 201 South Main Street, Salt Lake City, Utah. I am the Managing Director, Regulation for PacifiCorp's Eastern Service States.

Qualifications

Q. Briefly describe your education and business experience.

A. I have a degree in Business Studies from the University of Strathclyde, I am a graduate of the Institute of Personnel and Development and I have completed the ScottishPower Business Leadership Program conducted by the Wharton Management School, University of Pennsylvania. I have worked for the Scottish Power Group of companies in a variety of management roles in.

Q. What are your responsibilities in your current position at PacifiCorp?

A. As Managing Director, Regulation, my responsibilities include managing the regulatory proceedings in the states of Utah, Wyoming and Idaho, including the management of all filings that are made by PacifiCorp with the Idaho Public Utilities Commission (Commission).

Purpose and Summary of Testimony

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide an overview of the Company's 2005 Idaho general rate case filing, including a discussion of the following points:

- The rate increase request, test period, and inter-jurisdictional cost allocation methodology,

- The cost drivers that led to this rate case filing,
- The implications of this filing on the Company's financial integrity,
- The Company's efforts to mitigate impacts on its Idaho customers,
- The Company's cost control efforts,
- The reasonableness of the requested increase, and
- An introduction of Company witnesses.

Rate Case Overview

Q. What is the total rate increase requested by the Company is this case?

A. The Company's requested net overall price increase is $11.4 million, or 9.2 percent. The 9.2 percent increase represents an average across all customer classes. The specific impacts on customer classes are discussed in the testimony on Mr. William R. Griffith. The requested rate increase is capped in accordance with the terms of the Multi-State Process (MSP) stipulation which is currently awaiting approval by the Commission. The MSP cap is discussed in the testimony of Mr. David L. Taylor. Further, the requested rate increase reflects the impact of the expiration of the Power Cost / Tax surcharge (Schedule No. 93), which ends at the same time as the effective date of the proposed rates in this case.

Q. What test year has PacifiCorp used to determine its revenue requirement in this case?

A. The Company has used an historical test year that begins April 1, 2003 and ends March 31, 2004 (FY 2004). The base test year is adjusted for known and measurable costs and investments as presented in the testimony of witnesses in the case. This approach is consistent with the past practice of the Commission which has favored the use of an historical test period with known and measurable adjustments extending beyond the end of the historical test period. The purpose of the known and measurable adjustments is to match as closely as possible the change in rates with related costs being incurred to serve Idaho customers.

Q. You mentioned the MSP stipulation. Does this filing incorporate the Revised Protocol inter-jurisdictional cost allocation methodology proposed in the MSP stipulation pending before the Commission?

A. Yes. As Mr. Taylor explains in his testimony, the Company's request was developed under the Revised Protocol inter-jurisdictional cost allocation methodology. In accordance with the MSP stipulation, the Company's request in this case was limited by the Rate Mitigation Cap. The application of this cap resulted in a requested rate increase that is $1.8 million less than the increase calculated using the Revised Protocol without a cap.

Rate Case Drivers

Q. Please explain why the Company is filing for a requested increase at this time.

A. The last general rate case in Idaho was filed in 1985 with rates being set in April 1986. Due to a number of limited issue base rate reductions since 1986, PacifiCorp's ongoing base rates are actually about 7 percent *lower* today than they were in 1986. These intervening base rate reductions have totaled over $7 million.

Additionally, since 1986 PacifiCorp has recovered, with Commission approval, a net amount of approximately $16 million through three temporary surcharges and three temporary surcredits. As measured by ongoing base rates, however, the Company has implemented the above rate reductions in the face of significant cost increases experienced over the same period. As measured by the Producer Price Index (PPI), for example, which tracks changes in the wholesale prices of finished goods, prices have increased some 38.9 percent since 1986. If the Company's 1986 operations and maintenance (O&M) costs had increased at the same rate as the PPI, ongoing base rate increases of approximately $10 million in Idaho would have been necessary since that time. This is in contrast with over $7 million in base rate reductions actually experienced by the Company's Idaho customers and illustrates the efforts that the Company has made to effectively manage costs for the benefit of its Idaho customers.

The combined impact of decreasing rates and the continuing impact of increasing inflation on the Company's operating costs is clearly a significant driver in this rate case. In addition, specific issues have triggered the need for requesting rate relief, including:

1. Increases in pension costs and costs related to providing health care coverage to employees, and
2. Recovery of investments required for new generation resources.

Q. What is driving the increases in pension costs and costs related to providing health care coverage to employees?

A. As Mr. Rosborough discusses in more detail, the Company has incurred increased costs related to pensions and health insurance. External factors, such as the downturn in the financial markets and significant increases in medical costs, are driving these increases. Although the Company has mitigated some of the impact of those increases with internal cost control initiatives, these externally driven costs are largely unavoidable. Rising costs in these areas are not unique to PacifiCorp or even to the utility sector. Personnel-related costs such as pension and health benefits are a significant portion of the Company's overall costs.

Q. Please describe the investments the Company has made in new generation resources referenced above.

A. Three long-term system resources are or will be in-service during the relevant periods in this case: the West Valley lease agreement, the installation of three General Electric LM-600 generation units at the Gadsby plant site, and Phase I of the 525 MW combined cycle combustion turbine generating facility at Currant Creek. Mr. Watters' testimony demonstrates that these resources were prudently acquired and provide system-wide benefits to all of the Company's customers, particularly the Company's Idaho customers.

Impacts of Rate Case on Company's Financial Integrity

Q. What is the Company's current rate of return and how does that compare to the request in this application?

A. PacifiCorp is currently earning a normalized return on equity of only 5.8 percent in Idaho, as described in Mr. Weston's testimony. This is considerably lower than the 13.40 percent approved in Utah Power's 1985 general rate case, and when applied to current conditions, falls substantially short of the 11.125 percent return on equity supported by Dr. Hadaway's testimony in this proceeding. Dr.

Hadaway's testimony indicates a range of appropriate levels of return on equity from 10.7 percent to 11.4 percent. The Company is requesting that the Commission approve a return on equity of 11.125 percent which reasonably falls toward the middle of the range identified by Dr. Hadaway. An allowed return on equity in range proposed by Dr. Hadaway would send a positive signal to the capital markets at a time when the Company is embarking on a cycle of significant capital investment.

Q. How will the rate increase sought in this case contribute to PacifiCorp's financial strength?

A. The requested rate increase will support the financial strength of the Company by allowing the Company an opportunity to earn a reasonable return on investment. As explained by Mr. Watters, PacifiCorp's 2003 Integrated Resource Plan (IRP) calls for the development of 4,000 megawatts of power supply resource by FY 2013. This growth cycle will require that the Company maintain a financial rating that will permit access to capital markets at reasonable costs. By granting the Company's requested rate increase, the Company will be able to maintain the financial strength necessary to attract the capital required to meet the growing needs of customers through the acquisition or development of the power supply resources projected in the IRP.

Without the requested rate increase, it will be very difficult for the Company to meet the challenges presented by increasing costs and investment requirements necessary to meet the growing electrical service needs of its Idaho customers.

Mitigation of Impacts on Customers

Q. What efforts has PacifiCorp made to help its Idaho customers mitigate their energy costs?

A. The Company has mitigated the impact on customers by diligently pursuing available credits from the Bonneville Power Administration (BPA) for eligible Idaho customers. Throughout the 1980s and most of the 1990s, PacifiCorp's Washington, Oregon, and Idaho customers enjoyed substantial energy credits from BPA's Residential Exchange Program. During this time, PacifiCorp's Idaho customers received annual benefits in the range of $15 - $26 million. In 1997, the total annual BPA credit for PacifiCorp's Idaho customers fell to $3 million and stayed roughly at that level for the following three years. In 2000, conscious of Idaho's needs as an agricultural state, PacifiCorp began negotiations with BPA to secure a higher level of credit for its Idaho customers. PacifiCorp successfully negotiated two separate agreements spanning BPA's Fiscal Years 2001 – 2006 that provided Idaho customers with $36 million in annual benefits. This level of benefit currently provides a credit of $0.039/kWh, or a discount of over 50 percent for the average irrigation customer, and a credit of $0.023/kWh for non-irrigation customers.

PacifiCorp recently completed a new round of negotiations in an effort to extend the BPA credit past 2006. The result of these negotiations is a new agreement, based on a formula for the difference in BPA rates and market prices, that will provide PacifiCorp's Idaho customers with annual credits in the range of $8.6 - $21.3 million for the five-year period 2007 – 2011. PacifiCorp's efforts to work with BPA and the Idaho Commission on behalf of its Idaho customers has resulted in reduced energy prices for Idaho customers that are among the lowest in the nation.

Q. What else has the Company done to soften the impact of this requested rate increase and to help customers manage their energy costs?

A. Pursuant to Commission Order No. 29034, PacifiCorp committed to work with irrigators to develop an optional load control program beginning with the 2003 irrigation season. The Irrigation Load Control Credit Rider program was designed to help irrigators manage their energy costs by providing energy credits for voluntary load curtailment during specified periods. The 2003 program enjoyed considerable success, with 207 customers participating at 403 individually metered sites. The program curtailed in excess of 20 megawatts per day and resulted in a total of $277,584 of credits being paid to participating customers over the four-month irrigation season. Enrollment for the 2004 irrigation season increased more than 50 percent from the 2003 program with 340 customers participating at 734 sites and resulted in a total of $410,325 of energy credits being paid to participating customers. This resulted in a daily load curtailment in excess of 30 megawatts during the 2004 irrigation season.

In response to feedback received from PacifiCorp's irrigation customers, PacifiCorp proposed modifications to the load control program for the 2005 irrigation season that have been filed and approved by the Commission. These modifications expand the options for participating customers by providing additional choices for curtailment intervals to best match the individual needs of our irrigation customers. We anticipate the participation in 2005 will build on the success achieved in the past two seasons and enable additional customers to actively participate in the management of their energy costs.

Q. **Are there other efforts the Company has made to help Customers manage their energy costs?**

A. Yes. The Company's experience is that information about the Company's planned rate changes and the reasons for those changes is helpful to customers as they make decisions which may affect their energy consumption. Over the last several months, the Company has met with almost 100 customers, community leaders, and legislators to explain the reasons necessitating this general rate case and other rate filings before the Commission. In these public meetings, we have explained the background behind the current and expected BPA credit levels, the Company's rate case activity in other states, the history of rate cases in Idaho, and the reasons for this rate case filing. We further explained that the expected timing of the effective date of the price increase from this rate case will occur at the end of the 2005 irrigation season, leaving almost a full year for irrigators to plan their farming operations and energy consumption prior to the beginning of the next irrigation season.

Of course, the reaction of the meeting participants is that no one wants either rate increases or reduced BPA credits levels. However, participants generally appreciated the information provided by the Company because it helps them understand the reasons for rate changes, and plan for and manage expected changes in their energy costs.

Company Cost Control Efforts

Q. What efforts has the Company made to mitigate the need for rate increases through cost controls?

A. Cost control efforts are one of the main reasons the Company has been able to provide excellent value to its Idaho Customers and to achieve declining base rates since 1986, in spite of inflationary pressures that have caused the PPI to increase 38.9 percent over that time period.

PacifiCorp has achieved cost efficiencies through many different initiatives, including improved call center operations, new procurement cost savings, and implementing internal process changes. For example, the Company has controlled costs by modifying its planning and budgeting processes to better match the regulatory process and the rate impacts of its business decisions. All budgets are reviewed with regard to the level a particular cost is currently being recovered in customer rates. In this way line managers are more aware of the consequence each cost increase will have in the form of customer rate increases. This approach establishes a discipline within all areas of the organization to recognize and manage the impact of business decisions and cost increases on the prices customers pay.

Reasonableness of Requested Increase

Q. Why do you believe the Company's requested rate increase is reasonable?

A. The Company takes seriously its obligation to keep customer prices as low as possible and does not take the request of a price increase lightly. The base data in this case has been used as the basis for the Company's recent rate cases in Utah and Oregon. Through the scrutiny of these rate cases we have refined and improved the data to meet the objective of keeping our rate increase request as conservative as possible, while seeking to recover the revenue necessary to allow the Company an opportunity to earn a reasonable return on investment.

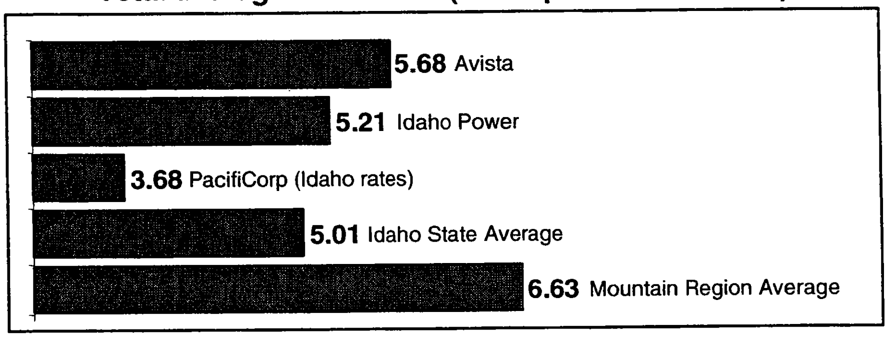
Further, as discussed earlier in my testimony, we work hard to help customers mitigate their energy costs and to limit the need for rate case increases by controlling our own operating costs. The Company has been able to limit the net overall price increase in this case through the efforts discussed and through a deliberate effort to seek a price increase that is as conservative as possible.

As noted earlier, since base rates were last set by the Commission in 1986, PacifiCorp rates have decreased. PacifiCorp's request for a net overall price increase of 9.2 percent based on rates that are lower than they were in 1986 is clearly reasonable and will continue to represent an excellent value to Idaho customers.

Q **If approved as filed, how will PacifiCorp's Idaho prices compare with other utilities?**

A. As stated in the Commission's Fiscal Year 2004 Annual Report, "Idaho's electricity rates are among the lowest in the nation." Based on information from the Edison Electric Institute, PacifiCorp's current retail average rates rank 171st lowest out of 172 utilities. If the full rate increase were granted PacifiCorp rates would rank as the 165th lowest among 172 utilities. On a regional basis, as shown in the chart below, PacifiCorp rates in Idaho are very low when compared to other Idaho utilities, and other regional utilities.

Total average retail rates (cents per kilowatt-hour)



When comparing PacifiCorp's electric rates to that of other utilities, PacifiCorp's request for a net overall price increase of $11.4 million, or 9.2 percent, is reasonable. Granting this request would allow the Company an opportunity to earn a reasonable return on investment and to continue meeting the growing electrical service needs of customers in Idaho by providing safe and reliable energy.

Introduction of Witnesses

Q. Please list the Company witnesses and provide a brief description of their testimony.

A. The Company witnesses filing direct testimony are:

Samuel C. Hadaway, FINANCO, Inc., will testify concerning the Company's return on equity. Based on a DCF (Discounted Cash Flow) methodology confirmed by a risk premium analysis, as well as a review of the current market, the electric utility industry, and company-specific factors, Mr. Hadaway proposes a point value for PacifiCorp's cost of equity of 11.125 percent.

Bruce N. Williams, Treasurer, will testify concerning the Company's cost of debt and preferred stock. Mr. Williams will show the Company's embedded cost of long-term debt to be 6.34 percent and the embedded cost of preferred stock to be

6.64 percent. He will also explain the calculation of the average capital structure for the utility for the test year.

J. Ted Weston, Regulation Manager, will present the Company's overall revenue requirement based on normalized results of operations for a FY 2004 test year with known and measurable adjustments. Mr. Weston will present the normalizing adjustments to actual test period results related to revenue, operation and maintenance expense, net power costs, depreciation and amortization, taxes and rate base.

Mark T. Widmer, Director, Net Power Costs, will describe the operation of the GRID model, including the new VISTA model for hydro normalization, and the calculation of net power costs.

Stan K. Watters, Senior Vice President, Commercial & Trading, will provide information regarding the West Valley lease, the Gadsby Project and the Currant Creek generation project.

Daniel J. Rosborough, Director of Employee Benefits, will testify to the Company's increased pension and employee benefit costs. Mr. Rosborough will also address the actions the Company is taking to control these rising costs.

David L. Taylor, Principal Regulatory Consultant, explains the cost allocation procedures that apply following the adoption of the new MSP Protocol in Idaho. Mr. Taylor also presents testimony on class cost of service and functional revenue requirement.

William R. Griffith, Director of Pricing and Regulatory Operations, will present testimony on three primary areas: 1) description of the Company's pricing objectives, 2) the Company's proposed rate spread, and 3) the Company's proposed changes in price design for the affected rate schedules.

Q. Does this conclude your direct testimony?

A. Yes.