Docket No. UM-1050
Exhibit PPL/200
Witness: Steven R. McDougal

BEFORE THE PUBLIC UTILITY COMMISSION

OF THE STATE OF OREGON

PACIFICORP

Direct Testimony of Steven R. McDougal

September 2010

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

A. My name is Steven R. McDougal, and my business address is 201 South Main, Suite 2300, Salt Lake City, Utah, 84111. I am currently employed as the director of revenue requirement.

Qualifications

Q. Briefly describe your educational and professional background.

A. I received a Master of Accountancy degree from Brigham Young University with an emphasis in Management Advisory Services in 1983 and a Bachelor of Science degree in Accounting from Brigham Young University in 1982. In addition to my formal education, I have also attended various educational, professional, and electric industry-related seminars. I have been employed by PacifiCorp or its predecessor companies since 1983. My experience at PacifiCorp includes various positions within regulation, finance, resource planning, and internal audit.

Q. What are your responsibilities as director of revenue requirement?

A. My primary responsibilities include overseeing the calculation and reporting of the Company's regulated earnings or revenue requirement, assuring that the inter-jurisdictional cost allocation methodology is correctly applied, and explaining those calculations to regulators in the jurisdictions in which the Company operates.

Q. Have you testified in previous regulatory proceedings?

A. Yes. I have provided testimony before the Public Service Commission of Utah, the Washington Utilities and Transportation Commission, the California Public

Utilities Commission, the Idaho Public Utilities Commission, the Public Service Commission of Wyoming, and the Utah State Tax Commission.

Purpose of Direct Testimony

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

A. My direct testimony addresses the calculation and implementation of the 2010 Protocol allocation methodology. Specifically, I provide direct testimony on the following:

- calculation of the Company's projected revenue requirement for calendar years 2010 through 2019 and the corresponding inter-jurisdictional allocation (Baseline Study);
- a review of historical results using the Revised Protocol;
- changes between the Revised Protocol and 2010 Protocol, including changes in allocation factors, the calculation of the Embedded Cost Differential (ECD), the fixed allocation adjustments for each state, and treatment of costs related to the Klamath Hydroelectric Settlement Agreement (KHSA);
- information to be included the Company's future results of operations reports and rate cases related to the 2010 Protocol and the calculation of the ECD;
- changes to the following appendices included with the direct testimony of Ms. Andrea L. Kelly: 1) Appendix B – Allocation Factor Applied to each Component for Revenue Requirement; 2) Appendix C – Allocation factor – Algebraic Definitions; 3) Appendix D – Special Contracts; 4) Appendix E – 6-Year Levelized Fixed Dollar Embedded Cost Differential Hydro Endowment; and 5) Appendix F – Methodology for Determining Mid-C (MC) Factor; and

- allocation of State resources associated with: 1) Demand-Side Management Programs; 2) Portfolio Standards; 3) State-specific Initiatives; and 4) New QF Contracts.

Baseline Study

Q. Why did the Company prepare the Baseline Study?

A. As described by Ms. Kelly, the Company prepared the Baseline Study at the request of the Multi-State Process (MSP) Standing Committee. The purpose of the study was to compute a current projection of revenue requirement for calendar years 2010 through 2019 and produce the inter-jurisdictional allocation according to the Revised Protocol, Rolled-In, and Modified Accord allocation methodologies. The study was designed to facilitate MSP participants' assessment of the ongoing reasonableness of Revised Protocol to determine if modifications were needed. The focus of the Baseline Study was to create a tool that could be used to compare current expectations of the future on varying allocation methodologies. The Baseline Study is not intended to precisely predict annual revenue requirement through calendar year 2019 and does not serve to predict future rate setting proceedings or price changes in any state. Rather, it serves to model differing allocation assumptions and is used as an analytical tool to assess the impact of those assumptions on the states served by the Company.

The purpose of the Company's baseline study was described using the following language circulated to MSP participants:

> "These attachments represent the Company's best efforts to provide reasonable draft projections of the differences in allocation methodologies over the 10-year study horizon. Emphasis was put on forecasting items that are treated differently and would create differences

> between the allocation methodologies used. Less time was spent on items that are treated the same in the various allocation methodologies, since this would not impact the comparisons between allocation methodologies. As such, the focus of the analysis was on the relative differences between allocation methodologies, as opposed to the absolute level of total company revenue requirement."

Q. Please describe how the Company produced the Baseline Study.

A. Study preparation began in mid-2009. Projected revenue requirement was based on actual 2008 costs which were escalated through the study time horizon to reflect inflation and expected changes in the Company's resource base consistent with the 2008 Integrated Resource Plan (IRP). System net power costs (NPC) were computed consistent with these assumptions as described in the direct testimony of Mr. Gregory N. Duvall. Jurisdictional allocation factors were calculated for each year of the study using the forecast load from the Company's February 2009 load forecast. Jurisdictional revenue requirement was then calculated according to Revised Protocol and compared to the allocation methodology preferred by each state prior to adoption of Revised Protocol, either Rolled-In or Modified Accord. Preliminary results of the study were provided to MSP participants on August 17, 2009.

Q. Why were the August 2009 results considered preliminary?

A**.** The August 17, 2009 study was considered a draft by the Company and was provided to MSP participants in order to vet the modeling of assumptions and the resulting revenue requirement. The results were also considered preliminary because of the treatment of the Klamath hydro project. At this stage in the process the KHSA had not yet been finalized; consequently, the preliminary study assumed that Klamath would be relicensed and included cost assumptions based on the best information available at that time. After circulating the preliminary results in August 2009, the Company solicited feedback from the MSP participants in workgroup meetings. As described by Ms. Kelly, several Utah parties subsequently issued a notification to MSP participants questioning the continued used of Revised Protocol. The Company gathered input from MSP participants, continued to refine the revenue requirement modeling, and awaited finalization of the KHSA in order to produce the final Baseline Study.

Q. When was the Baseline Study finalized?

A. Once the KHSA was finalized, the Company incorporated it and other feedback from MSP participants into the revenue requirement modeling, and the Baseline Study was finalized and shared with MSP participants in March 2010.

Q. What were the results of the Baseline Study?

A. Exhibit PPL/201 provides the results of the Baseline Study. Revenue requirement using Revised Protocol for each state is compared to the allocation methodology used by that state prior to adoption of Revised Protocol, either Rolled-In or Modified Accord.

Q. Was the Baseline Study compared to the study performed in 2004 supporting Revised Protocol (the 2004 Study)?

A. Yes. The relative differences by state between Revised Protocol and Rolled-In or Modified Accord in the Baseline Study were compared to the relative differences between the same allocation methodologies used in the Company's 2004 Study. The results are shown in Exhibit PPL/201. This comparison spurred continued discussion among the MSP participants regarding whether Revised Protocol will perform as originally expected based on updated expectations of the future.

Q. Were there any additional analyses performed based on the Baseline Study results?

A. Yes. At the request of the Standing Committee, the Company performed alternative studies related to varying wholesale market prices, the value of operating as a single integrated system, and the impact of load growth.

Q. Please describe the study related to wholesale market prices.

A. The Standing Committee requested a study to test the potential impact on each jurisdiction under Revised Protocol with a given change in wholesale market prices, one using high market prices and one using low market prices. The direct testimony of Mr. Duvall describes the corresponding calculation of NPC and I incorporated his revised NPC results into the revenue requirement model. A summary of the results is provided in Exhibit PPL/202.

Q. Please describe the studies performed on the value of the single integrated system.

A. Two studies, a structural separation study and go-it-alone analysis, were completed to estimate the benefits of the Company continuing to plan and operate as a single integrated system. The direct testimony of Mr. Duvall describes each of these studies in greater detail along with the calculation of the impact on NPC in each scenario. The results of these studies are provided in the direct testimony of Mr. Duvall.

Q. Please describe the load growth study.

A. An additional study was conducted to estimate the impact of load growth on the various jurisdictions. The study began with the baseline study. Load growth was then adjusted in Utah and Wyoming, the two fastest growing jurisdictions, to a level consistent with other states. Using the revised load data, the following three changes were made to the revenue requirement calculation: 1) NPC were updated, as described in the direct testimony of Mr. Duvall; 2) jurisdictional demand and energy used to compute inter-jurisdictional allocation factors were updated; and 3) rate base and operation and maintenance costs were updated to be consistent with the change in loads and resources. The results of the study for both Revised Protocol and Rolled-In are included in Exhibit PPL/203. The net impact of the change to the dynamic allocation factors and net power costs was an allocation of 103 percent of the incremental cost of load growth to Utah and Wyoming, the fastest growing states. The slower growing states all receive a slight benefit from the load growth because of the reallocation of fixed costs.

The load growth study showed that the dynamic allocation factors utilized under a Rolled-In allocation methodology protect individual states from bearing the cost of load growth in other states. This study showed that currently load growth is not an issue and is not expected to be an issue in the future. On the contrary, Revised Protocol was shown to have a great deal of volatility related to the calculation of the ECD and is therefore not a singularly effective protection mechanism against load growth.

Historical Results

Q. Did the Company compare historical results utilizing Revised Protocol to the 2004 Study?

A. Yes. An analysis was prepared to help the MSP participants better understand how the Revised Protocol has performed historically. The results of this analysis are shown in Exhibit PPL/204. This analysis shows there is a great deal of volatility in the Revised Protocol results, driven mainly by the ECD calculation. As a result, considerable analysis was done on various options to the ECD resulting in the changes described later in my testimony.

2010 Protocol

Q. Please describe the major differences between the 2010 Protocol and the Revised Protocol.

A. The 2010 Protocol is a simplified version of the Revised Protocol that is intended to reduce unintended variation in the allocation of actual revenue requirement as compared to the forecasts used in the 2004 Study and the Baseline Study. The specific changes to Revised Protocol incorporated into the 2010 Protocol are identified below.

- **Factor Changes:** Similar to Revised Protocol, the 2010 Protocol is based on an initial Rolled-In allocation of system costs. Resources classified as seasonal for Revised Protocol (including simple cycle combustion turbines and the Cholla Unit 4/APS exchange) will no longer be uniquely allocated, but will follow a Rolled-In allocation. Consequently, the allocation of system costs, prior to the application of the ECD and KHSA deviations, is the same as the Rolled-In allocation methodology.

- **<u>ECD Changes:</u>** The scope of the ECD has been modified in the 2010 Protocol, specifically related to Qualifying Facility (QF) contracts and the "All Other" generation resources category. All QF contracts entered into prior to September 15, 2010, are considered system resources in the 2010 Protocol and will not be considered as part of the ECD calculation. New QF contracts will also be considered system resources unless deemed to be priced greater than comparable resources. The embedded cost of "All Other" generation resources includes only resources that were part of the Company's integrated system prior to 2005.

The ECD calculation, prior to levelization, was done using forecasted information from the Baseline study, using the following three sections from the Revised Protocol ECD calculation:

<u>Company Owned Hydro - West:</u> This section was calculated the same as under Revised Protocol.

<u>Mid-C Contracts:</u> This section was calculated the same as currently used in all Company filings. The Grant Reasonable contract is included as an offset to the Mid-C contract costs.

<u>Generation Costs – Pre-2005 Resources ("All Other" Generation):</u> This section was calculated the same as in Revised Protocol with the exception that the calculation of the embedded cost of "All Other" resources only included costs and MWh associated with pre-2005 resources.

- **<u>ECD Levelization:</u>** The value of the modified 2010 Protocol ECD is calculated for each state in the Baseline Study, levelized, and fixed for all rate cases filed through December 31, 2016, rather than allowed to float with each rate case or other regulatory filing.
- **<u>Klamath Costs:</u>** All costs related to the KHSA are initially allocated to all states in unadjusted results. The depreciation expense associated with Klamath assets will be adjusted on January 1, 2011, in order to fully depreciate these assets by December 31, 2019. The system allocation of Klamath costs is consistent with the benefits of the hydro output under the Rolled-In allocation methodology. As part of the 2010 Protocol agreement, an adjustment is made to reverse the initial system allocation of the KHSA surcharge expected to be paid for by Oregon and California customers and situs assigns it to those states based on the amounts stipulated in the KHSA. This re-allocation of costs is consistent with the reallocation of hydro benefits accomplished through the ECD component of the 2010 Protocol. The surcharge included in the Baseline Study is levelized and fixed for the period 2011 through 2016 and included in the 2010 Protocol at the levelized amount.

Q. Why is the scope of the ECD limited to only pre-2005 resources in the "All Other" generation resource category?

A. During the MSP meetings, the costs of "All Other" generation were identified as one of the components causing variability in the Revised Protocol ECD calculation. Several options were studied for the "All Other" generation cost component, including using pre-1989 resources to correspond with the date of the original merger, using pre-2005 resources to align with the adoption of Revised Protocol, or continuing to base the "All Other" resources on current assets. The MSP participants agreed that since the ECD compares legacy hydro resources to "All Other" generation, using pre-2005 would provide a consistent calculation, and would exclude new resources acquired which may cause significant impacts on the calculation. The list of pre-2005 resources is provided as Exhibit PPL/205.

Q. What are the costs related to the KHSA and why is an adjustment necessary to re-allocate the KHSA surcharge?

A. Since the 2010 Protocol uses Rolled-In allocation as the baseline, it was decided that the KHSA costs will initially be system allocated. This is consistent with the treatment of costs for other system resources under Rolled-In, and is consistent with the benefit of the Klamath resources which are allocated to all jurisdictions under Rolled In. However, consistent with the ECD calculation which re-allocates the hydro costs and benefits to Pacific Power states, an adjustment will be made to the KHSA surcharge to undo the system allocation and directly assign the amount of the surcharge borne by California and Oregon through respective tariff riders in those states. This re-allocation does not revoke the right of parties in any jurisdiction to review the KHSA costs for prudency.

Q. Please explain how the ECD and KHSA surcharge will be levelized and fixed for the period 2011 through 2016.

A. The starting point for the levelized ECD and KHSA calculation is the annual amounts included in Exhibit PPL/206. The annual amounts were levelized using the 2008 IRP discount rate to come up with the six year net present value shown on the bottom of Exhibit PPL/207. Annual levelized amounts were then developed that result in the same net present value by jurisdiction over the six year period from 2011 to 2016.

Q. Please illustrate the revenue requirement difference between the 2010 Protocol and Revised Protocol.

A. The difference between results using the 2010 Protocol and Revised Protocol are shown on Exhibit PPL/208. This exhibit shows, for each jurisdiction, the revenue requirement difference from changing to 2010 Protocol.

Future Reporting

Q. What information will the Company provide in its results of operations reports and rate cases related to allocation methodologies?

A. Subject to the approval of the Company's application, jurisdictional revenue requirement in future results of operations reports and rate cases will be calculated using the 2010 Protocol allocation methodology. In addition, all historical results of operations filed by the Company will include a calculation of the 2010 Protocol ECD using historical data. This will be provided for informational purposes for states to track the information over time. The Company proposes to no longer provide reports or comparisons using any other allocation methodologies.

MSP Appendix Modifications

Q. Please describe the changes to Appendix B – Allocation Factor Applied to each Component for Revenue Requirement.

A. Appendix B has been updated to remove allocation factors related to seasonal resources and the Cholla resource which are no longer used in 2010 Protocol.

The changes to Appendix B also include general cleanup and housekeeping, such as removing factor combinations no longer used and adding new factor combinations since Revised Protocol was originally developed.

Q. Please describe the changes to Appendix C – Allocation factor – Algebraic Derivations.

A. Derivations of factors related to seasonal resources and the Cholla Unit 4/APS exchange which are no longer used in 2010 Protocol have been removed. The income before tax factor has been removed, and state income taxes will be calculated using the statutory state effective tax rate, consistent with the methodology used to calculate state income taxes associated with rate changes in rate cases in all states. This change is necessary because of the volatility of calculating results for a single jurisdiction.

Q. Please describe the changes to Appendix D – Special Contracts.

A. This document remains unchanged, other than now labeling the document as "2010 Protocol". The appendix has two options for special contracts designed to provide consistency between the allocation of revenues, costs and benefits derived from adjusting allocation factors. Under option 1, the costs of a program are embedded in the tariff price, resulting in the jurisdiction approving the contract absorbing the full cost of the program, similar to demand-side management (DSM) costs. Since the costs are absorbed by the jurisdiction approving the contract, it also receives the benefits associated with the program through reduced allocation factors. Under option 2, the contract costs are separately identified and allocated to all states. Since the costs are allocated to all states and not to a specific jurisdiction, the monthly load used to calculate allocation factors is calculated assuming no curtailment occurs.

Q. Please describe the changes to Appendix E – 6-Year Levelized Fixed Dollar Embedded Cost Differential Hydro Endowment.

A. This document has been re-crafted to reflect the ECD from the 2010 Protocol and therefore replaces in its entirety, rather than changing Appendix E from the Revised Protocol. Under the 2010 Protocol, the ECD amount has been levelized and is set at a fixed amount. The ECD page has been updated to show the amounts that will be included in filings made through December 31, 2016.

Q. Please describe the changes to Appendix F – Methodology for Determining Mid-C (MC) Factor.

A. This document remains unchanged, other than now labeling the document as "2010 Protocol". The MC factor is utilized in the Baseline Study to compute the allocation of the projected ECD. However, because the ECD is fixed by year and by state in the 2010 Protocol, this factor will not be directly utilized in filings made prior to December 31, 2016.

State Resources

Q. How will State Resources be allocated in 2010 Protocol?

A. As mentioned above, state resources included: 1) Demand-Side Management Programs; 2) Portfolio Standards; 3) State-specific Initiatives; and 4) New QF Contracts. There is no change in the allocation of State resources, which continue to be situs allocated per the 2010 Protocol.

Q. Does this conclude your direct testimony?

A. Yes.