

1                   **BEFORE THE WYOMING PUBLIC SERVICE COMMISSION**

2                                   **Docket No. 20000-EA-05-226**  
3                                   **Direct Testimony of Marci L. Norby**  
4                                   **Filed: December 15, 2005**  
5                                   **REVISED COPY**

6  
7    **I. Introduction**

8    **Q     Please state your name, address, and occupation.**

9    A     My name is Marci L. Norby. My business address is 2515 Warren Ave., Suite 304,  
10        Cheyenne, Wyoming, 82002. I am employed as a Senior Rate Analyst with the  
11        Office of Consumer Advocate.

12  
13   **Q     Please describe your educational background, occupation, and experience.**

14   A     I received a Master of Science degree in Finance from the University of Wyoming in  
15        1999. After graduating, I was employed as a financial analyst in the banking  
16        industry, where my duties included accounting, capital budgeting, financial  
17        budgeting, bond portfolio management and administration, institutional investing,  
18        economic analysis, and financial operations. I came to the Wyoming Public Service  
19        Commission in August of 2000 and then to the Office of Consumer Advocate in May  
20        of 2003.

21  
22   **Q     Have you testified before the Commission in previous proceedings?**

23   A     Yes. I have included a list of my previous testimony before the Wyoming Public  
24        Service Commission as MLN Appendix A of my testimony.

25  
26   **Q     On whose behalf do you appear today?**

27   A     I appear in this case on behalf of the Office of Consumer Advocate (OCA).

28  
29   **Q     As a member of the OCA, do you advocate the interests of certain groups**  
30        **of consumers over others?**

31   A     No. As a member of OCA, it is my obligation to represent the interests of all

1 Wyoming citizens and all classes of utility customers in the state.  
2

3 **Q What is the purpose of your testimony in this proceeding?**

4 A The purpose of my testimony in this case is to present the results of my review of  
5 the application and my recommendations regarding the proposed acquisition of  
6 PacifiCorp by MidAmerican Energy Holding Company (MEHC) as it pertains to the  
7 potential financial and regulatory impacts of the transaction.  
8

9 **Q Do you sponsor any exhibits in this proceeding?**

10 A Yes, I sponsor OCA Exhibit MLN-1 in this proceeding. I will refer to my exhibit  
11 throughout my testimony.  
12

13 **Q How is your testimony organized?**

14 A I will first present the statutes pertinent to the review of the application. I will then  
15 present the results of my review and my recommendations regarding the financial  
16 and regulatory impacts of the application. Later in my testimony, I will present  
17 additional recommendations of the OCA that aid to mitigate uncertainties in the  
18 application.  
19  
20

21 **II. Standard for Review**

22 **Q What is the Wyoming statute applicable for reviewing the transaction in the**  
23 **application?**

24 A The primary standard regarding whether the transaction should or should not be  
25 approved by the Commission is found in W.S. § 37-1-104, which states:  
26

27 *(a) No reorganization of a public utility shall take place without prior*  
28 *approval by the public service commission. The commission shall not*  
29 *approve any proposed reorganization if the commission finds, after*  
30 *public notice and opportunity for public hearing, that the*

1            *reorganization will adversely affect the utility's ability to serve the*  
2            *public.*

3            *(b) For purposes of this section, "reorganization" means any*  
4            *transaction which, regardless of the means by which it is*  
5            *accomplished, results in a change in the ownership of a majority of the*  
6            *voting capital stock of a public utility, or the ownership or control of*  
7            *any entity which owns or controls a majority of the voting capital stock*  
8            *of a public utility. "Reorganization" as used in this section shall not*  
9            *include a mortgage or pledge transaction entered into to secure a*  
10           *bona fide borrowing by the party granting the mortgage or making the*  
11           *pledge.*

12  
13    **Q     Does the PacifiCorp and MEHC application for approval of the transaction**  
14    **meet the requirements of the statute?**

15    **A     Not completely. It is the OCA's assertion that the result of our examination**  
16    **illustrates several uncertainties included in the application which may adversely the**  
17    **public interest. I will refer to my comments and recommendations pertaining to the**  
18    **uncertainties in the application as well as several additional recommendations**  
19    **throughout my testimony.**

20  
21    I have included my comments in the context of changing, modifying, or adding to the  
22    commitments made by the companies in the application. I am using a consolidated  
23    list of commitments made by the companies in the application and my  
24    recommended changes or additions in OCA Exhibit MLN-1. My consolidated list  
25    includes the commitments made by the companies, and the OCA's recommended  
26    conditions of approval to mitigate gaps and uncertainties in the commitments  
27    presented in the application. The commitments and assurances that the companies  
28    have made in the application aid in mitigating some of the potentially troublesome  
29    issues, but the commitments and assurances fall short, or leave gaps in adequately  
30    protecting ratepayers from being made to pay unreasonable rates in the future. My  
31    following recommendations are intended to complete an appropriate package of

1 consumer protection provisions and close those gaps.

2  
3  
4 **III. The Commitments Included in the Application**

5 **Q What are the commitments that PacifiCorp and MEHC have made in the**  
6 **application?**

7 A I have provided a copy of a consolidated list of the commitments made in the  
8 application that was provided by MEHC and PacifiCorp to the parties in this case  
9 through discovery in OCA Exhibit MLN-1. This list includes at least 50 general  
10 commitments and a few Wyoming specific commitments made by MEHC and  
11 PacifiCorp. The list includes some revisions made by MEHC and PacifiCorp (as of  
12 October 19, 2005) to the original list of commitments presented in the application. I  
13 have used this list as a starting point for my recommendations in this case. The list  
14 also includes my recommended revisions and additions that I will discuss later in my  
15 testimony. I have not included any changes that may be discussed in Bryce  
16 Freeman's testimony in my exhibit.

17  
18 **Q Are any of the commitments made in the application current requirements of**  
19 **the utility and or its parent company?**

20 A Yes. Many of the commitments referred to in OCA Exhibit MLN-1 are items that are  
21 currently required of the companies. For example, commitment number 6 in the  
22 exhibit states:

23  
24 *The Commission or its agents may audit the accounting records of*  
25 *MEHC and its subsidiaries that are the basis for charges to*  
26 *PacifiCorp, to determine the reasonableness of allocation factors used*  
27 *by MEHC to assign costs to PacifiCorp and amounts subject to*  
28 *allocation of direct charges. MEHC agrees to cooperate fully with*  
29 *such Commission audits.*

30 While the OCA appreciates that MEHC and PacifiCorp have put forth this

1 commitment in the application, the Commission and its agents have authority to  
2 examine under oath any officer, agent or employee of such public utility<sup>1</sup> in relation  
3 to its business and affairs pursuant to W.S. §37-1-115.

4  
5 In addition, the companies are required to make their agents available to testify  
6 before the Commission (commitment 5), comply with all existing Commission  
7 statutes and regulations (commitment 7), and provide the Commission access to all  
8 books of account, documents, data, and records and its affiliated interest or which  
9 are otherwise relevant to the business of PacifiCorp (commitment 4). My point is  
10 that the list of commitments is quite long, but does not exclusively contain new  
11 commitments, which are not currently a requirement of the parties to the transaction  
12 and, therefore, the laundry list of benefits does not bring in as many benefits to  
13 Wyoming consumers as it would first appear.

14  
15 **Q What are your recommendations regarding the list of commitments presented**  
16 **by MEHC and PacifiCorp in the application in this case?**

17 **A** I am making several recommendations that modify and strengthen the commitments  
18 made in the application in order to mitigate uncertainties and risks to the consumers  
19 in Wyoming. I am presenting these recommendations in OCA Exhibit MLN-1 and I  
20 discuss these recommendations below.

21  
22 **Commitment Number 14 - Cost Allocation Methodologies**

23 **Q What are your recommendations concerning the cost allocation**  
24 **methodologies as presented in the application?**

25 **A** The OCA recommends that the Commission adopt changes to commitment 14(f)  
26 that state PacifiCorp will clearly defined and justify the costs and cost allocation  
27 methodologies, submit the applicable cost studies, and defined the associated rate  
28 impact of the costs in any general rate application (OCA Exhibit MLN-1).

29 The Applicant's proposed language in this commitment states that the cost

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1 Pursuant to W.S. § 37-1-101, the definition of a "public utility" includes every person that owns, operates, leases,

1 allocation methodology will be submitted to the Commission for approval, if required  
2 by law or rule. In the event of a general rate case the Company would be required  
3 to justify the cost allocation methodologies, the costs, and present the studies that  
4 the costs are based on. However, too often in applications submitted by utilities, the  
5 costs are not clearly illustrated or justified and, therefore, must be obtained through  
6 discovery, which only serves to lessen the amount of time interveners may have to  
7 put the case together. In addition, lack of complete justification at the time of filing  
8 does not give all of the information to the Commission, which lessens the  
9 Commission's ability to assess the full case before the hearing. The OCA has  
10 recommended language in this commitment to solidify PacifiCorp's duty to include  
11 such illustrations and justifications. The OCA's recommendation ensures not only  
12 that MEHC and PacifiCorp will submit the cost allocation methodology to the  
13 Commission, but also holds the Company to its burden to prove that its rates to  
14 Wyoming consumers only include the just and reasonable costs allocated from  
15 affiliates.

16  
17 **Commitment Number 16 – Transaction Costs**

18 **Q Are you making any recommendations in this case to the commitment**  
19 **concerning the transaction costs?**

20 **A** Yes. I am recommending changes to commitment 16 that clarify that MEHC and  
21 PacifiCorp will exclude all costs of the transaction from PacifiCorp's utility accounts  
22 *used in setting rates*. The companies' proposal states that all the costs would be  
23 excluded from PacifiCorp's utility accounts. Including the language "used in setting  
24 rates" provides a declaration that the costs of the transaction will be excluded from  
25 those utility accounts above the line that are used to set rates. The OCA  
26 recommended changes to commitment 16 also eliminate the word *provide* and add  
27 the assurance that MEHC will *file with the Commission* the preliminary and final  
28 accounting of the transaction costs. The word *provide* used in the companies'  
29 proposed language in the application is open to interpretation, and could include

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controls or has power to operate, lease or control.

1 providing the information to the Commission with a simple phone call. It is important  
2 that the Commission be more formally informed, in writing, of the cost of the  
3 transaction for the Commission's records.

4  
5 **Commitment Number 17 - The Transaction Premium**

6 **Q Are you recommending any changes to the MEHC and PacifiCorp commitment**  
7 **regarding the acquisition premium?**

8 **A** Yes. MEHC and PacifiCorp's proposed language in commitment number 17 is as  
9 follows:

10  
11 *For accounting purposes, the premium paid by MEHC for PacifiCorp*  
12 *will be recorded in the accounts of the acquisition company and not in*  
13 *the utility accounts of PacifiCorp. MEHC and PacifiCorp will not*  
14 *propose to recover the acquisition premium in PacifiCorp's regulated*  
15 *retail rates; provided, however, that (1) if the Commission in a rate*  
16 *order issued subsequent to the closing of the transaction reduces*  
17 *PacifiCorp's retail revenue requirement through the imputation of*  
18 *benefits (other than those benefits committed to in this transaction)*  
19 *accruing from the acquisition company (PPW Holdings LLC),*  
20 *Berkshire Hathaway, or MEHC;, and (2) if the Commission fails to*  
21 *recognize in rates the costs associated with such benefits, then*  
22 *MEHC and PacifiCorp reserve the right to propose upon rehearing*  
23 *and in subsequent cases a symmetrical adjustment to recognize the*  
24 *acquisition premium in retail revenue requirement. MEHC and*  
25 *PacifiCorp acknowledge that neither the Commission nor any party to*  
26 *a rate proceeding subsequent to the closing of the transaction is*  
27 *required by this commitment to allow or support inclusion of any*  
28 *portion of the acquisition premium in PacifiCorp's rates.*

29  
30 The OCA is recommending that the commitment should more appropriately read as  
31 follows:

1  
2 *MEHC and PacifiCorp agree that the acquisition premium paid by*  
3 *MEHC will not be included for recovery from PacifiCorp's consumers*  
4 *in Wyoming in any proposed regulated retail rate.*  
5

6 **Q Why are you recommending this change?**

7 A The MEHC and PacifiCorp proposed language is not in the public interest because  
8 the recovery of the acquisition premium is economically unreasonable, lacks  
9 foundation under regulatory theory and practice, and would lead to higher rates and  
10 excessive returns based on a premium to the book value of PacifiCorp's assets.  
11 The notion that an acquisition premium should ever be recovered in rates to  
12 Wyoming consumers should be eliminated in this proceeding.  
13

14 **Q What is an acquisition premium?**

15 A The acquisition premium is the difference between the purchase price paid for  
16 PacifiCorp and the book value of its assets to be acquired. The companies'  
17 estimate of the acquisition premium in this case is approximately \$1.2 billion.  
18

19 **Q Are you recommending that the acquisition premium should not be allowed to**  
20 **be recovered in rates at any time?**

21 Yes. In a general rate case, the ultimate prices that a utility is authorized to charge  
22 are based on the calculated rate base, which is based on the net book value (the  
23 original cost standard) of its assets. If at any time Wyoming consumers are required  
24 to pay for the acquisition premium in rates, the consumers of Wyoming will be  
25 harmed directly by the transaction through unreasonable rates. Paying higher rates  
26 simply because the utility has been acquired by another entity is not a cost that  
27 consumers should be required to pay, not a cost of doing business, and not in the  
28 public interest.

29 If the acquisition premium is allowed into rates at any time, now or in the future, it  
30 will result in **inflating the book value** of the assets for consumer rate purposes.

1           Allowing for recovery of an acquisition premium only serves to reinforce the use of a  
2           higher than reasonable regulatory book valuation of assets, which goes directly  
3           against the fundamental principle of regulatory finance that market value should,  
4           over the long run, equal book value. Calculation of the rate base and its return is  
5           based on book values without any obligation to maintain market prices in excess of  
6           book value. The proposal of MEHC and PacifiCorp to potentially recover the  
7           acquisition premium in a subsequent case, if the consumers are awarded more  
8           benefits in a revenue requirement established by the Commission, only serves to  
9           provide the potential for the company to secure a value of the utility's assets that is  
10          higher than the book value of those assets.

11  
12          Allowing the valuation to exceed book value fails the regulatory requirement of  
13          balancing consumer and investor interest as set forth in the 1944 U.S. Supreme  
14          Court's decision in the case of the Federal Power Commission versus Hope Natural  
15          Gas Company.<sup>2</sup> In addition, the basis for the regulatory valuation of the utility rate  
16          base is book value in regulatory proceedings and the fair value is the end product of  
17          the process of ratemaking not the starting point.<sup>3</sup> The crux of the matter is that  
18          consumer rates are not authorized dependent on an inflated market value.

19  
20          The Commission must ensure that utility ratepayers are not subjected to paying  
21          rates that produce an excessive and unreasonable rate of return. This is essentially  
22          what would happen if the acquisition premium were allowed to be recovered in any  
23          subsequent case. The acquisition premium contemplates future earnings from *other*  
24          *than* regulated operations or assets (where profits are limited by book value)  
25          because acquisition premiums contemplate future earnings from the synergies  
26          created between the various affiliates (regulated and unregulated) that will form the  
27          new holding company system.

28          Take into consideration the 1970s. In the 1970s, many of the utilities' market to  
29          book ratios were below one. If a utility company was acquired at a discount during

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<sup>2</sup> *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591.

<sup>3</sup> *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591.

1 that period, it seems unlikely that the utility would have petitioned the commission of  
2 applicable jurisdiction to allow it to decrease the regulatory book value of its assets  
3 to coincide with the price that it paid for the acquisition of the company. The reason  
4 that a Company would not have petitioned the Commission for such a decrease in  
5 valuation is that market value should, over the long run, equal book value and  
6 regulation is about book value and original cost of assets.

7  
8 A regulatory standard allowing the acquisition premium to be recovered in rates  
9 would only encourage the buying and selling of utilities for the sole purpose of  
10 increasing their value on the corporate books without any tangible benefit to  
11 consumers. This is precisely the type of adverse impact on consumers that should  
12 be avoided relative to changes in ownership. If the Commission were to regularly  
13 allow the recovery of acquisition premiums in rates, there would be no incentive to  
14 limit the amount of the price paid to purchase a utility. Bidding wars could ensue,  
15 causing chaos and market instability. The more appropriate signal for regulators to  
16 send is any premium that is paid will be paid by investors (not ratepayers) so that,  
17 properly, the acquisition premiums will be tied to the level of future benefits that  
18 investors expect will come from entering into the transaction.

19  
20 In addition, the MEHC in PacifiCorp proposed commitment number 17, as presented  
21 by the company, is contrary to commitment number 23, which states:

22  
23 *MEHC and PacifiCorp guarantee the customers of PacifiCorp will be*  
24 *held harmless if the transaction between MEHC and PacifiCorp result*  
25 *in a higher revenue requirement for PacifiCorp than if the transaction*  
26 *had not occurred; provided, however, that this hold harmless provision*  
27 *will not apply to prudently incurred costs approved for the inclusion in*  
28 *revenue requirement by the Commission.*

29  
30 The transaction costs as well as the premium paid for PacifiCorp in the transaction  
31 would be a harm to consumers if they were included in a revenue requirement, in

1 contradiction to this “hold harmless” commitment.

2  
3 The OCA realizes that the parties to the transaction are not seeking recovery of the  
4 acquisition premium in rates *in this case*. However, they have requested the  
5 Commission support their commitment that provides for the opportunity to seek  
6 recovery in the future. The Commission should not approve the companies’  
7 proposed commitment and make it clear that no acquisition premium may be  
8 included in rate base or expenses to be recovered in rates now or in the future. By  
9 adopting the OCA recommendation on this issue the Commission can effectively  
10 mitigate uncertainties of the possibility of inflated, unreasonable returns in the future.  
11 This will also provide clarity to the investors, eliminating uncertainties as to the  
12 expected earnings and cash flows from the utility.

13  
14 **Q If the acquisition premium is not recovered through rates paid by Wyoming**  
15 **consumers, will the companies ever be able to recover the acquisition**  
16 **premium?**

17 **A** This is irrelevant to the regulatory process in Wyoming. It is reasonable to presume  
18 that the companies expect that the acquisition will create economic benefits between  
19 the various affiliates (regulated and unregulated) within this holding company  
20 system. These benefits will not be shared with ratepayers, which is just one more  
21 reason why the acquisition premium should **not** be shared with ratepayers.

22  
23 One of the benefits that may be expected by investors is included in the Purchase  
24 and Sale Agreement, Section 5.12 (Post Closing Payments), where it appears that  
25 there are future benefits that may accrue to investors regarding a payment of \$4  
26 million per year plus interest for 25 years due from PacifiCorp Financial Services Inc.  
27 (PFS) to MEHC. PFS is a wholly-owned subsidiary of ScottishPower, and will  
28 apparently remain the ScottishPower. Because there's no mention of this \$4 million  
29 annual payment over 25 years in the testimony, and the fact that there has been  
30 limited explanation in a data response from the companies regarding this issue, it is

1 unclear whether the acquisition premium has been mitigated or will be mitigated with  
2 these annual payments. However, it is clear that there is a benefit in receiving \$4  
3 million a year plus interest for 25 years. This is a benefit that is *most likely* not  
4 expected to be shared with ratepayers, due to the fact that it was not included in the  
5 application or the testimony.

6  
7 **Commitment Number 19 - Capital Structure**

8 **Q Are you recommending any changes to the capital structure commitment?**

9 **A** Yes. I am recommending changes to commitment 19 to ensure that PacifiCorp will  
10 notify the Commission *in writing* if for any reason its common equity capital is  
11 reduced to below 44% of its total capital because of distribution's to PPW Holdings  
12 LLC or MEHC for a period longer than three consecutive months. I'm also  
13 recommending that the *written* notification to the Commission include the *reasons*  
14 for the changes in the capital structure, the amount of time it is expected to remain  
15 below 44%, justification related to any reason why the Company believes the new  
16 capital structure is reasonable, and a discussion of any expected changes to  
17 PacifiCorp's credit rating that may result from the changed capital structure. I have  
18 included and am recommending these changes because it is important that the  
19 Commission not only be informed that the percentage of common equity capital has  
20 decreased below the threshold in this commitment, but also the reasons why the  
21 change has occurred. It is also important to inform the Commission if this is an  
22 expected long-term change in the capital structure, and if so, why the change is  
23 reasonable, as well as what the market and analysts reactions are to this change (if  
24 applicable). By keeping the Commission informed of the overall picture of the  
25 situation, the Commission will be able to ensure that upstream distributions (from  
26 PacifiCorp to its parent or affiliate) are not hindering the operational or financial  
27 ability of PacifiCorp to serve its customers and Wyoming.

28  
29 The capital structure of a company can change a revenue requirement by millions of  
30 dollars and can potentially change the credit rating of the Company. This is an  
31 important consumer issue because of the potential rate implications and potential

1 changes in the credit rating, affecting the cost of debt. The capital structure of a  
2 Company can affect the overall financial health and its comparability to other  
3 companies in its industry, which are public interest concerns. It is important that the  
4 Commission is completely informed of potential significant changes in capital  
5 structure due to distributions, from PacifiCorp to its parent company.

6  
7 It will also be important for the Commission to consider any increases in the equity  
8 ratio, or general changes in capital structure. For instance, increases in equity ratio  
9 can mean higher rates for ratepayers because it will increase the cost of equity  
10 capital. Increases in the equity ratio can also mean a cross subsidization between a  
11 utility and its parent if the ratepayers of the utility are paying higher rates due to a  
12 higher percentage of equity capital and that higher percentage of equity capital is  
13 offsetting a higher debt level of the parent company. In essence, the offset to the  
14 parent's high debt level may aid the parent company's maintenance of a certain  
15 credit rating at the cost of higher rates to the captive ratepayers. However, the  
16 consideration of this issue by the Commission can be instituted in subsequent rate  
17 cases where the capital structure is generally considered for its appropriateness.

18  
19 **Commitment Number 38 – Reduced Cost of Debt**

20 **Q What are your recommended changes to the reduced cost of debt**  
21 **commitment?**

22 **A** I am recommending changes to commitment number 38 that clarify: (1) that  
23 PacifiCorp will file any rate application with at least a 10-basis point reduction to the  
24 yield actually incurred on any incremental long-term debt issuances over the next  
25 five years, (2) that this five-year commitment is effective for the five years  
26 subsequent to the *close* of this transaction instead of when the transaction is  
27 approved, and (3) that it is the *yield* spread of 10 basis points. While the proposed  
28 language merely states that PacifiCorp will accept up to a 10 basis point reduction in  
29 incremental long-term debt, the OCA recommended changes to commitment  
30 number 38 ensure that PacifiCorp will *file* the 10 basis point reduction in any general

1 rate application that it files in the future. I am recommending this language change  
2 because it makes certain that PacifiCorp will file its general rate applications with the  
3 inclusion of the 10 basis point reduction.  
4

5 **Q Is this commitment a certain benefit to Wyoming consumers, going forward?**

6 A No. The 10 basis point reduction on incremental debt could be a benefit to  
7 Wyoming customers in the amount of \$6.3 million over the next five years.  
8 However, there's no assurance of how much incremental debt will be issued in the  
9 future. Therefore, the amount of the benefit to consumers is uncertain.  
10

11 **Commitment Number 39 - Corporate Overhead Charges**

12 **Q Do you have recommendations regarding commitment number 39 in OCA  
13 Exhibit MLN-1?**

14 A Yes. The OCA recommends changes to commitment number 39 regarding  
15 corporate overhead charges (OCA Exhibit MLN-1). The OCA recommendation  
16 provides some certainty to the commitment proposed by the Company by providing  
17 for a formal filing of the IASA (Intercompany Administrative Services Agreement)  
18 and clarifying that the \$9 million to which the companies have agreed does not  
19 constitute any ratemaking precedent as to any assurance in this case that  
20 PacifiCorp will collect the entire \$9 million in corporate overhead charges. The OCA  
21 recommends that the Commission adopt this language in its order to ensure that in  
22 any ratemaking proceeding PacifiCorp must prove that \$9 million (or less) is  
23 reasonable.  
24

25 **Q What are the lingering uncertainties regarding this commitment?**

26 A The \$9 million commitment is a cap on overhead charges over the next five years.  
27 The companies' calculation depicts this as a benefit of \$6 million, which is the  
28 difference between the ScottishPower corporate overhead charges represented in  
29 the application and the \$9 million cap. There is an uncertainty as to what will  
30 happen after the initial five year period and if this will be or should be more than a \$6

1 million benefit to consumers.

2  
3 **Commitment Number 48 - Corporate Presence**

4 **Q What are your recommended changes to commitment number 48, corporate**  
5 **presence?**

6 A My recommended changes include changing the word *understand* to the word *agree*  
7 in order to further mitigate uncertainties relating to this commitment. It is more  
8 important that the companies agree in this case that it is important to operate the  
9 company with adequate staffing levels instead of just adequate staffing levels to  
10 ensure the safety of the operations, the safety of its workers, and the reliability of the  
11 system and it is important that that is illustrated in subsequent cases. I am  
12 presenting this recommendation to illustrate changes that I would like to see in the  
13 commitment and to demonstrate to the Commission that language in the order in  
14 this case should be deliberate.

15  
16 **Other Commitment Comments**

17 **Q Does the PacifiCorp and MEHC list of commitments provide assurances that**  
18 **alleviate concerns regarding corporate abuses in cross subsidies?**

19 A MEHC and PacifiCorp have included several commitments in the application similar  
20 to that provided by PUHCA. For example, the parties to the transaction have made  
21 assurances that PacifiCorp will maintain (1) a separate accounting system, (2)  
22 provide the Commission access to books and records, (3) provide the Commission  
23 or its agents the opportunity to audit the accounting records of MEHC and  
24 PacifiCorp, (4) require that PacifiCorp will file an affiliate interest report annually, (5)  
25 assurance of no cross subsidization between regulated and unregulated businesses  
26 or between any regulated businesses, (6) and ring fencing provisions for diversified  
27 activities. In addition, MEHC and its subsidiaries have committed to maintaining  
28 audit trails and positive time recording systems where applicable. PacifiCorp will  
29 maintain separate debt and preferred stock ratings. Dividends and distributions to  
30 the parent company made by PacifiCorp will not reduce PacifiCorp's common equity

1 capital below 40% without prior Commission approval, and PacifiCorp will not  
2 assume any obligation or liability of MEHC or its affiliates without prior Commission  
3 approval.

4  
5 The companies have set forth a laundry list of commitments that do provide some  
6 assurances that corporate abuses and cross subsidies are not a part of their  
7 business plan. However, as the OCA has illustrated above, there are still gaps and  
8 uncertainties. The OCA has recommended several additional commitments for the  
9 Commission's consideration in order to ensure that ratepayers in Wyoming are  
10 protected from potentially unreasonable rates and practices resulting from the  
11 transaction.

12  
13 **Q Are you making any further comments in regard to other commitments made**  
14 **by the company in this case?**

15 **A** In OCA Exhibit MLN-1, I am also recommending changes to commitment numbers  
16 6, 12, 21, and 31. I recommended language changes in these commitments mainly  
17 include assurances that notifications to the Commission will be *in writing*, the  
18 Company will gain *prior* approval of the Commission before making loans or transfer  
19 of funds to MEHC or its affiliates, and inclusion of the ability of the Commission to  
20 audit the accounting records of MEHC in its subsidiaries to determine the  
21 reasonableness of *the costs and* allocation factors. I recommend that the  
22 Commission adopt my language changes to these items in order to bring clarity to  
23 the companies' commitments. As with all of my recommendations for language  
24 changes, I recommend that the Commission consistently used deliberate language  
25 in its order in this case in order to ensure that future interpretation of its order is  
26 clearly understood.

27  
28 **IV. OCA Additional Recommendations**

29 **Q Are you recommending any an additional commitments that are needed from**  
30 **the company in order to ensure that the transaction will not adversely affect**

1 **the utility's ability to serve the public?**

2 A Yes. I have included additional OCA recommendations in OCA Exhibit MLN-1. My  
3 additional recommendations in this case will aid in mitigating uncertainties in the  
4 application that may adversely affect the consumers and public interest.

5  
6 **OCA Exhibit MLN-1 – Commitment Number 51**

7 **Q What are your recommendations pertaining to your additional commitment**  
8 **number 51?**

9 A I am recommending additional language that states:

10  
11 *MEHC and PacifiCorp agree to provide safe, adequate, and reliable*  
12 *service at reasonable rates and will make it a priority to make its best*  
13 *effort to provide that service at reasonable, stable rates.*

14  
15 This recommendation requires PacifiCorp to make it a priority and bestow its best  
16 effort to provide service at reasonable, stable rates as it enters a time frame in which  
17 it is proposing to significantly increase its rate base. It is important for the  
18 ratepayers in Wyoming to have some assurance that PacifiCorp will keep this  
19 important issue in the forefront as it makes future investment decisions.

20  
21 **OCA Exhibit MLN-1 – Commitment Number 52**

22 **Q What are your recommendations that pertain to the transactions between**  
23 **PacifiCorp, MEHC, and other affiliates within the holding company system?**

24 A I am recommending an additional item that includes assurances that any  
25 transactions for non-power goods and services between PacifiCorp and MEHC or  
26 other affiliates protect the public interest and captive consumers from any potential  
27 unfair self-dealing within the holding company structure.

28 My recommendation in OCA Exhibit MLN-1, number 52 states:

29  
30 *MEHC and PacifiCorp agree that the transactions for goods or*

1            *services between PacifiCorp and MEHC or other affiliates that are*  
2            *proposed to be incorporated in PacifiCorp's rates to consumers will be*  
3            *proposed to be recovered in PacifiCorp rates at the higher of market*  
4            *value or cost if PacifiCorp is selling goods or services to its parent*  
5            *company or affiliate and at the lower of market value or cost if*  
6            *PacifiCorp is purchasing goods or services from an affiliate or parent.*

7  
8            I am making this recommendation because it is important that the Commission  
9            consider potential transactions between PacifiCorp and MEHC or other affiliates in  
10           this case in order to ensure that the public interest is not adversely affected by such  
11           transactions between companies within the same holding company system that may  
12           not be arm's length transactions. The Commission should create certainty that the  
13           operational and financial dealings of the public utility are not manipulated in the  
14           monopolistic environment, and that the holding company, or other affiliates, do not  
15           perform of services at unreasonable costs or unfairly allocated excessive portions of  
16           costs, which are ultimately paid by the ratepayers.

17  
18           While the Commission cannot dictate what MEHC and its affiliates pay each other  
19           for goods and services, the Commission has the regulatory authority to determine  
20           what PacifiCorp may recover in its Wyoming rates. The OCA recommendation to  
21           require the *at cost or market value* standard in this case would enable the  
22           Commission to ensure that services performed by a parent company or affiliate may  
23           be recovered economically and efficiently. The premise for this recommendation is  
24           economic efficiency in that if PacifiCorp is buying a product and the market price is  
25           higher than the cost at which PacifiCorp can produce it, PacifiCorp should provision  
26           that good or service itself rather than purchasing it. Conversely, if the market price  
27           is lower than the cost of PacifiCorp producing the good or service the Company  
28           should buy it.

29  
30           Under this recommendation, the Commission will still need to painstakingly consider  
31           any proposed costs as compared to market valuations in rate cases, but the

1 Commission will have mitigated potential corporate abuses that could inflate costs or  
2 otherwise subject ratepayers to unreasonable rates. My recommendation also  
3 allows the Commission to effectively control costs to PacifiCorp by ensuring that  
4 those costs are reasonable, efficient, and economical. The Commission should  
5 diligently secure safeguards to ensure effective ratepayer protection against  
6 subsidization between regulated and unregulated businesses as well as between  
7 regulated businesses.

8  
9 **Q How would the company calculate the market valuation for goods and**  
10 **services?**

11 A In a general rate case, PacifiCorp would be required to prove that the costs paid for  
12 services it receives from its parent or affiliates meet the requirement that I am  
13 recommending in this case. By the same token, in meeting that burden, the  
14 Company must also illustrate that the market value provided in that analysis is  
15 realistic.

16  
17 **Q Are you expecting that there will be corporate abuses between MEHC and**  
18 **other affiliates as they pertain to any transactions with PacifiCorp?**

19 A I am not accusing or predicting that there will be corporate abuses in this holding  
20 company system. I am recommending the additional standard in order to guard  
21 against corporate abuses. The “at cost” standard is a standard that was developed  
22 in order to protect consumers from potential manipulation in a monopolistic  
23 environment. In order to guard against abuses, the services performed within a  
24 holding company system were required to be performed economically and efficiently  
25 and at cost. The services provided by mutual service companies were required to  
26 be provided at a reasonable savings as compared to contracts performed by  
27 persons independent of the particular holding company system. PUHCA ensured  
28 that holding companies and affiliates could not force utility subsidiaries to purchase  
29 financial, managerial, construction, and other services from a holding company or  
30 other affiliates at inflated prices. PUHCA mitigated corporate abuses that could

1 inflate or otherwise convey wrong information to shareholders while passing on  
2 unreasonable rates to ratepayers. It is important for the Commission fill in the gaps  
3 left by the repeal of PUCHA by ensuring that these transactions between the parent,  
4 affiliates, and PacifiCorp do not force Wyoming ratepayers to pay for unreasonable  
5 costs.

6  
7 **Q Was the "at cost or market value" standard incorporated in PUHCA?**

8 A No. The "at cost" standard is an SEC standard. The "cost or market value"  
9 standard has been the FERC standard for several years for non-power goods and  
10 services to a public utility. Currently, the FERC has requested comments in Its  
11 Notice of Proposed Rulemaking (Docket No. 05-32-000) regarding whether it should  
12 adopt rules under the Public Utility Holding Company Act of 2005 that incorporate  
13 the SEC's "at cost" standard or the "at cost or market value" standard currently used  
14 by the FERC.

15  
16 **Q Is your recommendation regarding the higher or lower of market value or cost  
17 a burden on the company?**

18 A My recommendation may require more resources to be developed to calculate a  
19 reasonable market value for providing goods and services than if the companies  
20 only justified charges to or from PacifiCorp on an 'at cost" basis. However, as I  
21 stated above, if PacifiCorp is buying a product and the market and the price is  
22 higher than PacifiCorp would incur by producing the good or service itself, then  
23 PacifiCorp would start producing the product (and vice versa for selling a product).  
24 For instance, the application states that MEC will provide budgeting for PacifiCorp.  
25 If PacifiCorp went into the market to hire a third-party to produce its budget every  
26 year, they would certainly consider if the price charged by the third-party was higher  
27 than what it would cost PacifiCorp to produce the budget itself. If the market price  
28 was higher, it would not be prudent for the Company to buy the service from the  
29 third-party rather than produce the budget itself. By requiring the analysis and  
30 comparison of the market value of the service that PacifiCorp is buying from the

1 parent company or an affiliate, the Commission has the ability to assess that  
2 analysis, and ensure that the costs of doing business with its parent or affiliate is  
3 effectively controlled and that the costs are just, reasonable, efficient, and  
4 economical.

5  
6 Is it important for the Commission to consider more than just the cost of the parent  
7 or affiliate company that may be presented in the general rate case. If there is no  
8 comparison available for the cost for the service from the parent or affiliate, and thus  
9 the charges to PacifiCorp, it is difficult to ascertain if those costs calculated by the  
10 affiliate or the parent are just and reasonable. The market valuation is a good  
11 comparison that will enable the Commission to determine if the rates based on such  
12 costs are just and reasonable pursuant to W.S. § 37-3-101.

13  
14 **Q Does this recommendation include those items in the IASA?**

15 A My recommendation includes all non-power goods and services that could be  
16 obtained from a third-party. There may be a few goods and services provided by  
17 the parent company or affiliates that are only available from PacifiCorp or its parent  
18 or affiliate. An example of this may be strategic management or support for the  
19 board of directors. However, that shouldn't exempt the companies from providing  
20 necessary detail for those costs or reasons why those goods or services can not be  
21 obtained in the market.

22  
23 **Q Why is this recommendation fair?**

24 A Using a cost versus market valuation, as I stated above, is essential for enabling the  
25 Commission to determine if the rates based on the cost of the affiliate selling goods  
26 and services to PacifiCorp are reasonable. Presenting only the costs of the affiliate  
27 that is selling the goods and services to PacifiCorp may illustrate that the *calculation*  
28 of the cost is reasonable, however, there would be no basis to determine if the  
29 affiliate selling the goods or services is selling those goods and services under  
30 efficient operating costs. If there is nothing with which to compare an internal cost of  
31 an organization in a cost study, it is difficult if not impossible to ascertain if the

1 organization is efficiently operating and, therefore, if the costs are economical given  
2 other options in the market. It is unfair for the consumers in Wyoming to be required  
3 to pay rates for utility services provided by a monopoly where justification may be  
4 questionable.

5  
6 **Q Should the Wyoming Public Service Commission wait for the conclusion of**  
7 **the Notice of Proposed Rulemaking<sup>4</sup> currently being conducted at the Federal**  
8 **Energy Regulatory Commission in order to make a determination regarding**  
9 **the appropriate cost standard?**

10 A No. The Commission should *not* adopt a *wait and see* approach. The Commission  
11 has the charge to ensure that the costs of PacifiCorp, and the rates based on those  
12 costs are just and reasonable in Wyoming. If the Wyoming Commission requires  
13 that the rates based on affiliate transactions between PacifiCorp and its parent  
14 company and other affiliates adhere to the *lower or higher of cost or market*  
15 standard, and that requirement turns out to be different from that which ends up in  
16 the FERC rules, it will not mean that the Wyoming Commission will need to change  
17 this requirement. The Wyoming Commission has jurisdiction over the regulated  
18 retail rates in Wyoming. To ensure that the Wyoming rates are just and reasonable,  
19 the Wyoming Commission should require that the costs that PacifiCorp pays to  
20 affiliates (and vice versa) meet that burden. It is unclear if companies such as  
21 MEHC will be subject to holding company requirements such as a cost allocation  
22 issue under PUHCA 2005 because such companies may be exempt. It is therefore,  
23 imperative that the Commission take action in this case, on this issue, to ensure that  
24 the cost of the transactions between affiliates render rates to PacifiCorp customers  
25 in Wyoming that are just and reasonable. By adopting the OCA recommendation on  
26 this issue, the Commission will be able to compare the cost to PacifiCorp from an  
27 affiliate and know with certainty that the rates that it may order in Wyoming are just  
28 and reasonable.

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4 Federal Energy Regulatory Commission. Notice of Proposed Rulemaking. Repeal of The Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005. Docket number RM05-32-00. September 16, 2005.

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**OCA Exhibit MLN-1 – Commitment Number 54**

**Q OCA commitment number 54 incorporates a Utah state specific commitment. What are your recommended changes to the commitment?**

A My recommended for changes to this commitment are minimal. My recommendation includes adding the assurance that PacifiCorp or MEHC will notify the Commission *in writing* prior to the implementation of plans to form a new affiliate, commencing business transactions with existing affiliates, or dissolve an affiliate. My recommendation ensures that the communication between the companies and the Commission is formal. This will allow for the Commission to be kept informed of diversification of PacifiCorp's business, other than that of a regulated utility and as well as transactions between PacifiCorp and its affiliate that may enable the Commission to assess any potential impacts to the ratepayers in Wyoming.

**OCA Exhibit MLN-1 – Commitment Number 55**

**Q Why have you made a recommendation regarding the possibility of PacifiCorp obtaining a downstream loan from its parent company or any affiliate company?**

A MEHC and PacifiCorp have not made a commitment regarding any downstream loans (loans from a parent or affiliate to PacifiCorp). In discussions with the companies the OCA was told by PacifiCorp and MEHC that downstream loans would not occur between the companies in the holding system going forward. However, in response to a data requests to the Utah Committee of Consumer Services (number 4.11) the companies stated “Furthermore, any downstream loans to PacifiCorp from its holding company would be on reasonable terms without markup to the holding company's cost of funds.”

I have added this commitment in OCA Exhibit MLN-1, in order to ensure that in the event that any debt is obtained by PacifiCorp from its parent or any affiliate company, PacifiCorp must demonstrate in any subsequent rate case filing that the

1 cost of this debt is comparable to or less than it could have obtained on the market.  
2 My recommendation also includes comparable terms and conditions of the loan.  
3 This demonstration will allow the Commission the information to make a proper  
4 decision on whether the cost of this debt is reasonable and appropriate and to  
5 determine whether it should be included in rates. The commitment also ensures that  
6 PacifiCorp will be required to demonstrate in any subsequent general rate case that  
7 the loan is on reasonable terms.  
8  
9

#### 10 **XIV. Conclusions**

11 **Q Will your recommendations mitigate the uncertainties in the application?**

12 **A** Yes. The OCA recommendations aid in closing the gaps left by the repeal of  
13 PUHCA. Our recommendations also provide further ring fencing of PacifiCorp,  
14 further notifications to the Commission that may affect the financial position of  
15 PacifiCorp, and necessitate that transactions and dealings between PacifiCorp,  
16 MEHC, and other affiliates are required to be at cost or market value assuring that  
17 the Commission will have all of the relevant information in order to make an  
18 informed decision regarding the appropriate costs potentially included in rates to  
19 Wyoming ratepayers. The OCA's recommendations also mitigate a potential request  
20 by the Company to create an adverse impact to Wyoming ratepayers through a  
21 recovery of an acquisition premium (inflating the book value of assets) in Wyoming  
22 rates.  
23

24 The OCA also recommends additional reporting requirements in this case. In  
25 Wyoming, there are no formal periodic reviews of the Company. The additional  
26 reporting requirements recommended by OCA, as well as those formulated in the  
27 application, ensure that the Wyoming Commission will be informed if certain  
28 parameters highlighted in my testimony are reached. The additional reporting  
29 requirements help to mitigate uncertainties regarding the transaction, going forward.  
30 The information required in the reports to the Commission will enable the

1 Commission to remain informed and further ensure that the transaction and  
2 operations after the transaction is complete are in the public interest. The  
3 Commission is able to initiate an investigation if the uncertainties develop into  
4 adverse effects to the public interest.

5  
6 As I have stated earlier, the companies outline consumer benefits in the application.  
7 For example, the companies have committed that the corporate overhead costs will  
8 be reduced to \$9 million per year for the first five years. The uncertainty exists that  
9 we don't know if the cost should be less than \$9 million, for per year. Therefore, we  
10 are uncertain that the benefit of the transaction will yield a \$6 million cost savings.  
11 The OCA recommendations regarding the \$9 million in corporate overhead charges  
12 does ensure that there are no remaking implications in this case regarding the  
13 collection of the entire \$9 million because this cost may be less.

14  
15 MEHC and PacifiCorp have also stated in the application that they will accept up to a  
16 10 basis point reduction in any incremental cost of debt over the next five years.  
17 However, it is uncertain that the referred to \$6.3 million savings over the next five  
18 years will actually be realized because it is uncertain exactly how much debt will be  
19 issued over the next five years. The OCA's recommendation in this instance  
20 ensures that the Company will at least file a 10 basis point reduction in any  
21 incremental debt for subsequent rate cases over the next five years, as a benefit to  
22 ratepayers.

23  
24 Of course there are other uncertainties regarding the future of the operation and  
25 management of PacifiCorp that the OCA has not mitigated in its recommendations.  
26 For instance, there is uncertainty regarding how having MEHC in the mix will affect  
27 the progress as well as future legal proceedings in the federal lawsuit, or potential  
28 advocacy of legislation by MEHC in Wyoming regarding the pre-approval of assets  
29 to be included in rate base and the subsequent collection in rates of the cost of  
30 those assets, similar to legislation enacted in Iowa.

1 **Q Won't PUHCA 2005 also take care of a lot of the concerns regarding cross**  
2 **subsidization between regulated and unregulated affiliates, access to books**  
3 **and records, and allocation of the cost of non-power goods and services?**

4 **A** Not necessarily. It is unclear what companies will be exempt from many of these  
5 requirements under PUHCA 2005. In fact, in MEHC's comments to FERC regarding  
6 the Notice of Proposed Rulemaking on October 14, 2005 it states: MEHC "concur  
7 with the Commission's general premise that it will not implement PUHCA 2005 in  
8 such a manner that it will apply to companies that are not now subject to PUHCA  
9 1935." The Company further states "These nontraditional and "passive" investors  
10 should not be subject to the books and records requirements of Section 1264 of  
11 EAct 2005 and the allocation of costs of non-power goods and services addressed  
12 in Section 1275 of EAct 2005 and should be exempt from the Commission  
13 approval of their security issuances." The final rules that FERC is contemplating are  
14 not due out until 90 days after the effective date of the act, which is February 8,  
15 2005. Therefore, I reiterate that it is very important that the Wyoming Commission  
16 carefully consider those gaps left by the repeal of PUHCA 1935 and institute  
17 measures in Wyoming that continue consumer protections, mitigate potential cross-  
18 subsidization, require access to books and records, satisfy cost allocation standards  
19 and the prudence of those costs, and implement ring fencing mechanisms. While it  
20 is true that several of these mechanisms such as MEHC and PacifiCorp's  
21 commitment regarding access to books and records helped fill those gaps, the  
22 OCA's recommendations in this case aid in mitigating uncertainties and gaps that  
23 the companies have not addressed, such as the cost standards regarding  
24 transactions for non-power goods and services between PacifiCorp and MEHC or  
25 other affiliates, downstream loans from the parent company, and periodic reports.

26  
27 **Q Are you recommending that the Commission approve or deny this**  
28 **application?**

29 **A** The OCA recommendation in this case, constitutes a conditional approval wherein if  
30 the OCA recommendations are adopted by the Commission, the OCA recommends

1 approval. I am recommending that the Commission adopt the commitments made  
2 by the companies in the application with the OCA's changes to those commitments  
3 and the OCA's additional requirements to ensure that Wyoming ratepayers are not  
4 adversely impacted by the transaction proposed in this proceeding. There are  
5 several gaps and uncertainties in the application regarding whether or not  
6 ratepayers in Wyoming will be adversely affected. It is imperative that the  
7 Commission impose additional consumer protections and assurances through  
8 adopting the OCA recommendations in this case to guard against the uncertainties  
9 in the application regarding potential abuses, cross subsidies, and unreasonable  
10 rates to consumers and ensure that the ratepayers are not adversely affected.  
11

12 **Q Do you have any additional recommendations?**

13 A Yes. I am also recommending that any subsequent documents filed with the  
14 Commission regarding this transaction (such as the accounting of the transaction  
15 costs that are to be filed with the Commission 90 days after the close the  
16 transaction) should be filed publicly so that the interveners in this proceeding have  
17 the ability to review the documents, now or in the future.  
18

19 **Q Does this conclude your testimony?**

20 A Yes it does.