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IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC SERVICE TO ELECTRIC CUSTOMERS IN THE STATE OF IDAHO	CASE NO. IPC-E-03-13

IDAHO POWER COMPANY

DIRECT REBUTTAL TESTIMONY

OF

BRADLEY FOWLER

1 Q. Would you please state your name, business
2 address, and present occupation?
3 A. My name is Bradley Fowler, and my business
4 address is Milliman USA, Suite 3800, 1301 5th Avenue, Seattle
5 Washington 98101. I am a Principal and Consulting Actuary
6 specializing in pensions and employee benefits.
7 Q. What is your general educational background?
8 A. I graduated from the University of Washington
9 in Seattle in 1969 with honors, receiving a Bachelor of
10 Science degree in Mathematics. In 1971, I received a Master
11 of Arts degree from Cornell University in Mathematics. In
12 1979, I completed The Management Program in the Business
13 Department of the University of Washington.
14 Q. What is your professional educational
15 background?
16 A. The highest-level professional designation in
17 the actuarial profession is Fellowship in the Society of
18 Actuaries. This is obtained through a series of
19 examinations covering actuarial mathematics, principles of
20 insurance and employee benefits, investments, economics,
21 taxation, insurance and benefit law, accounting and
22 financial reporting, model building, underwriting, benefit
23 plan design, and plan funding. During the period when I was
24 pursuing the examinations, there were nine examinations,
25 requiring an average of 300 to 400 hours of study for

1 successful completion of each exam. I completed my
2 Fellowship in 1976. With the passage of the Employee
3 Retirement Income Security Act (ERISA) of 1974, actuaries
4 practicing in the area of pension plans were required to
5 become Enrolled Actuaries under ERISA to certify plan
6 funding to the IRS as required annually. I became an
7 Enrolled Actuary in 1980. My enrollment number is 02-3089.
8 In order to maintain my status as an Enrolled Actuary, I am
9 required to complete a minimum of 30 hours of continuing
10 education in supervised settings during each three year
11 period. I have completed this continuing education through
12 seminar attendance, and presenting seminars to others. I
13 have also made presentations to clients and other
14 professionals on topics such as pension funding, pension
15 accounting, and projection of pension funding and expense
16 requirements into the future. I am also a member of the
17 American Academy of Actuaries since 1978. This is the body
18 that develops qualification standards for its members to
19 sign statements of actuarial opinion, such as those
20 supporting the pension expense and obligation measurements
21 reported by companies like Idaho Power in their annual
22 reports to shareholders.
23 Q. Would you outline your business experience?
24 A. Milliman USA is an international firm of
25 actuaries and consultants with 1800 employees. Milliman

1 provides actuarial and administration services to many
2 pension plan sponsors, including Idaho Power Company. I
3 began working for Milliman USA, then called Milliman and
4 Robertson, in Seattle as a summer student in 1966, and I
5 continued working part time until 1972 when I joined
6 Milliman full time. In 1974, I transferred to M&R Services,
7 the data processing company of Milliman responsible for
8 large scale actuarial system development, and for operating
9 the firm's mainframe computer center. In 1979, I became the
10 Chief Operating Officer of M&R Services. In 1984, I
11 returned to Milliman as an actuary and consultant in the
12 retirement practice. I was elected a Shareholder of
13 Milliman in 1985, and a Principal in 1987. I began working
14 as the senior consultant and actuary for Idaho Power Company
15 in 1986, and have had responsibility for the actuarial
16 valuation of the Idaho Power Company Pension Plan since
17 1987. I am a senior Principal in the Seattle Employee
18 Benefits practice with management responsibility for several
19 major practice areas in addition to my consulting role. My
20 primary consulting relationships are with corporate clients
21 similar to or larger than Idaho Power Company, and with
22 several large non-profit hospitals.
23 Q. What services do you provide to Idaho Power
24 and its pension plan that are related to the Company's
25 current revenue requirement filing?

1 A. In my role as Idaho Power's plan actuary, I
2 supervise the annual valuation of the pension plan
3 liabilities. The valuation process measures the expected
4 payouts that will be due to participants from the plan,
5 using census data and assumptions regarding how long
6 participants are expected to work for Idaho Power, their
7 rates of salary growth, their expected lifetime following
8 retirement, and other contingencies affecting the amount of
9 benefits due. The valuation results are measured under the
10 FAS 87 required methods and assumptions for use in financial
11 reporting in Idaho Power's financial statements, and
12 separately under the IRS required methods and assumptions
13 for tax deductibility and minimum contribution purposes. I
14 sign the report that is used by Idaho Power and relied upon
15 by their auditors supporting pension expense in the
16 financial statements. I also sign the annual actuarial
17 report and filings made to the IRS under ERISA, certifying
18 that minimum contribution levels have been met. I consult
19 with Idaho Power regarding forecasts of future pension
20 expense and pension contributions, and recommend changes to
21 assumptions when appropriate.
22 Q. What is the purpose of your testimony in this
23 proceeding?
24 A. The purpose of my testimony is to offer
25 expert opinion on the pension cost items in Idaho Power's

1 filing and to respond to Staff witness Mr. Donn English's
2 recommendation that the Commission exclude all pension
3 expense from Idaho Power's revenue requirement.
4 Q. Idaho Power used the Service Cost methodology
5 to compute its pension cost in this case. What is your
6 opinion regarding the use of Service Cost as the basis for
7 pension cost recovery?
8 A. Service Cost computed on the basis of the
9 assumptions used for financial reporting represents a fairly
10 stable measure of the value of benefits being earned each
11 year. It is often used to convey the value of the plan to
12 participants, because it is independent of experience gains
13 and losses, and is relatively stable as a percentage of
14 covered payroll. However, for the purpose of utility rate
15 making, Service Cost does not include several other
16 important costs of providing the pension benefits. These
17 are the financing cost, which is the net effect of interest
18 cost on liabilities offset by investment income on plan
19 assets, and the cost of gains or losses due to experience
20 more or less favorable than assumed. Gains and losses occur
21 from assets earning more or less than assumed, retirees
22 living longer than assumed, salaries growing more slowly or
23 more rapidly than assumed, etc. In my opinion, the
24 financing cost, and the cost of gain or loss experience are
25 appropriately shared by the Company and its customers . The

1 impact of these elements may be either to lower total cost
2 below the Service Cost, or raise it above Service Cost.
3 Q. What is the most important characteristic to
4 consider in selecting a method for recognizing the cost of
5 pension benefits in utility rate making?
6 A. Consistency is the primary characteristic
7 that should be present in the treatment of pension cost for
8 rate making. By consistency, I mean consistency from one
9 rate filing to the next. This is also a primary
10 characteristic necessary for measurement of pension costs
11 for financial reporting purposes, and was one driver behind
12 the development of FAS 87, the accounting standard required
13 for financial reporting purposes.
14 Q. What basis for measuring the cost of pension
15 benefits do you believe is appropriate for utility rate
16 making purposes?
17 A. I support the use of FAS 87 Net Periodic
18 Pension Cost as the best measure of pension costs for rate
19 making purposes, because it is a publicly disclosed and
20 audited value, controlled by a well defined and consistent
21 accounting standard. This view is supported by the direct
22 testimony of Mr. English. FAS 87 was specifically developed
23 to create consistency of measurement from period to period,
24 and to facilitate comparison of pension costs on a
25 consistent basis from one company to another. Therefore, I

1 support using the net periodic pension cost included in the
2 Company's rate filing of $7,018,000, the net periodic
3 pension cost is the value prior to application of the
4 service cost adjustment proposed by the Company. Removing
5 the service cost adjustment results in a reduction of
6 $2,170,160 from the Company's proposed pension expense
7 amount. To that extent I agree that the adjustment proposed
8 by Mr. English is appropriate.
9 Q. Does consistency mean that the Net Periodic
10 Pension Cost is stable from period to period?
11 A. No. Changes in prevailing interest rates,
12 rates of inflation, rates of return on plan assets, and
13 other experience will impact the amount of the Net Periodic
14 Pension Cost. Large changes will impact the pension cost
15 significantly. The recent downward changes in interest
16 rates and large losses on pension assets have had a major
17 upward impact on pension expense for virtually all plans.
18 But the underlying methodology and discipline for
19 measurement, for selection of assumptions, and for
20 recognition of gains and losses is consistent. The
21 consistent use of Net Periodic Pension Cost also avoids
22 significant discretionary adjustments because of the public
23 and audited nature of the values.
24 Q. Mr. English proposes to adjust Idaho Power's
25 pension cost by an additional $1,379,148. What is your

1 opinion regarding this additional Staff adjustment to
2 pension cost?
3 A. The rationale provided by Staff for this
4 additional adjustment is invalid, and represents a
5 misunderstanding of the requirements of FAS 87. As reported
6 by Mr. English, the discount rate for 2003 was reduced from
7 7.00% to 6.75% and the future expected return on plan assets
8 was reduced from 9.00% to 8.50%. These changes resulted in
9 an increase in pension expense for Idaho Power. However,
10 these changes in assumptions were fully consistent with the
11 requirements of FAS 87. Milliman tabulated FAS 87
12 assumptions for 2003 for the largest 100 companies in the
13 US. The median discount rate used by these companies for
14 2003 was 6.75%, down from a median of 7.25% in 2002. The
15 median assumed long term rate of return on assets for these
16 100 companies declined from 9.50% in 2002 to 9.00% in 2003.
17 Additionally, the 2004 Greenwich Associates report states
18 that the mean reduction in rate of return on plan assets of
19 1,032 corporate pension plans between 2002 and 2003 was .40%
20 from 8.9% to 8.5%, as seen on Exhibit No. 70. The size of
21 Idaho Power's Plan is better represented in the Greenwich
22 Associates data which places Idaho Power at their median.
23 In general, smaller companies with smaller plans tend to use
24 slightly lower assumptions than the largest funds (Fortune
25 100 companies), in part because they incur greater

1 investment expenses as a percentage of assets.

2 Q. Is changing actuarial assumptions common?

3 A. Under FAS 87, it is not only common, but

4 required that the assumptions be re-examined annually. The

5 discount rate under FAS 87 is defined as the rate of

6 interest at which the obligations could be settled,

7 prevailing on or close to the measurement date for financial

8 statements. This means that in an environment of rapidly

9 falling interest rates, such as occurred from 2002 to 2003,

10 it was required that companies change their discount rate.

11 98 of the 100 largest companies in our study reduced their

12 discount rate from 2002 to 2003. The assumed long-term rate

13 of return on assets assumption is changed less often than

14 annually by most companies. Due to the fall in interest

15 rates over several years, and the fall in inflation,

16 however, it became increasingly hard for companies to

17 support the long-term rate of return assumptions used in

18 2001 and 2002 with the asset mix in the plans. This is

19 because yields on bonds, comprising for most plans 35% to

20 40% of the portfolio, had dropped into the 4% range. From

21 2002 to 2003 the great majority of companies reduced their

22 long-term rate of return assumptions on pension plan assets.

23 Q. Under the conditions described, would a

24 change in the investment policy of the pension plan be

25 needed to justify a reduction in the assumed return?

1 A. No. The basis for the reduction rested on the
2 fall in interest rates and inflation, not on a change in the
3 asset mix.
4 Q. Mr. English asserts that it is unusual or
5 irregular for the Company to document in a letter to the
6 Company's actuaries, Milliman USA, their choice of financial
7 assumptions for FAS 87 reporting purposes. Is he correct?
8 A. No. It is in fact appropriate and routine.
9 FAS 87 requires that the assumptions used for measuring
10 pension obligations and pension expense in the financial
11 statements of the Company represent management's best
12 estimate, subject to the requirements of FAS 87 for
13 selection of assumptions. This is consistent with the
14 general requirements of financial reporting, that the annual
15 statement is the report of management. The role of the
16 actuary is to advise the Company on their selection of
17 assumptions by providing advice on what we believe is
18 appropriate under the requirements of FAS 87 for the current
19 year, the actions of other similarly situated organizations,
20 and data on external relevant measures, such as bond yields
21 and annuity rates. Ultimately, it is the Company's decision
22 what assumptions to use. The actuary is required in our
23 report to state that we believe the reported results based
24 on these assumptions meet the requirements of FAS 87. I did
25 that on behalf of Milliman for Idaho Power Company for 2003.

1 The assumptions the Company selected were entirely
2 consistent with our recommendations, and with our
3 recommendations to other clients we serve. Further, the
4 entire annual report was subject to review by the Company's
5 auditors.
6 Q. Is the responsibility for selection of
7 assumptions different for reports to the IRS under ERISA?
8 A. Yes. Under ERISA, the Enrolled Actuary and
9 not the Company is responsible for the selection of
10 actuarial assumptions, and must certify that they represent
11 the actuary's best estimate. The definition of the
12 assumptions used under ERISA differs from the requirements
13 under FAS 87, and the ERISA assumptions are changed less
14 frequently.
15 Q. What is your opinion about the Staff's
16 proposed final reduction of $5,638,851 to pension expense?
17 A. I do not support the third adjustment. This
18 adjustment abandons FAS 87 Net Periodic Pension Cost
19 entirely as the basis for rate making, and substitutes the
20 cash contribution methodology. The critical need for using
21 a consistent methodology from year to year is disregarded
22 when the pension cost allowed is switched from a FAS 87
23 basis in one rate filing to a cash basis in the next.
24 Q. Why is FAS 87 Net Periodic Pension Cost for
25 the Idaho Power pension plan currently higher than the

1 required cash contribution?

2 A. There are two primary reasons.

3 (1) The liabilities under FAS 87 are measured

4 using a 6.75% discount rate for 2003. For cash

5 contributions, liabilities are measured using an 8% discount

6 rate. The FAS 87 basis produces a higher value for the

7 liabilities in the current interest rate environment. For

8 many years after the initial adoption of FAS 87, this

9 relationship was reversed. The discount rate for FAS 87 was

10 higher than the rate used for cash contributions.

11 (2) Idaho Power uses market value of assets

12 for determining their Net Periodic Pension Cost, and a

13 smoothed value of assets for computing the cash

14 contribution. At the beginning of 2003, the market value

15 was $282 million, while the smoothed value was $339 million.

16 The smoothed value recognizes gains and losses on plan

17 investments over a period of five years, so much of the very

18 bad asset performance in 2000-2002 was not yet reflected in

19 the cash contribution calculation. However, those losses

20 are still to be phased into that calculation. In that

21 sense, the FAS 87 cost is more up to date, because the

22 effect of the losses is more completely reflected.

23 Q. Will the FAS 87 Net Periodic Pension Cost

24 always remain higher than the cash contribution amount?

25 A. No. Looking at the period from 1986 when FAS

1 87 was adopted through 2003, a period of 18 years, Idaho
2 Power's contribution exceeded the Net Periodic Pension Cost
3 (NPPC) in 12 years, and was less than NPPC in 6 years. The
4 years where NPPC was higher have been primarily times when
5 the discount rate was low, and/or asset performance was poor
6 relative to assumptions. The times when cash contributions
7 have been higher have been times when the discount rate was
8 high and/or asset returns were well above assumptions.
9 Q. Is the cash contribution method recommended
10 by Mr. English less subject to discretion than the FAS 87
11 Net Periodic Pension Cost?
12 A. No, there is a greater level of discretion in
13 the cash contribution. The IRS permits several different
14 funding methods. For a particular year, different methods
15 produce different levels of minimum contributions. The IRS
16 allows companies to change methods every five years without
17 approval, and in certain cases more often with approval.
18 The IRS allows companies to use a smoothing method on plan
19 assets or to use market value. Companies may change asset
20 methods without approval every five years.
21 In many years, the calculation of the minimum
22 and maximum cash contributions produces a very large range.
23 The Company has the opportunity to select the amount of
24 their contribution within this range, and may vary their
25 contribution considerably from year to year.

1 All of these factors make the cash
2 contribution method recommended by Mr. English less stable
3 and consistent in methodology from year to year than the FAS
4 87 Net Periodic Pension Cost.
5 Q. Why not simply allow the lesser of the cash
6 contribution and the Net Periodic Pension Cost?
7 A. This is the equivalent of saying to the
8 Company, heads I win, tails you lose. The size of the cash
9 contribution and the Net Periodic Pension Cost will vary
10 differently from year to year, but over time, both
11 calculations reflect the size of the benefits actually paid
12 out to plan participants. Any over or under estimate made
13 along the way becomes an adjustment to amounts needed in
14 future periods. Taking the lower of the two results is a
15 method that will not ultimately pay the cost of the
16 benefits, because the cumulative amounts considered will be
17 less than the amounts calculated under either a cash method
18 or a FAS 87 method.
19 Q. What is prepaid pension expense?
20 A. Prepaid pension expense represents the
21 cumulative amount since the adoption of FAS 87 by which cash
22 contributions to the Idaho Power Pension Plan have exceeded
23 the recorded Net Periodic Pension Cost. So it represents
24 the excess of funding over what has been expensed.
25 Q. Is prepaid pension expense an asset of the

1 Company?

2 A. Yes, under generally accepted accounting
3 principles, as defined by FAS 87. Under FAS 87, the amounts
4 recognized as Net Periodic Pension Cost are by definition
5 the proper allocation of pension cost to current and past
6 periods for accounting purposes. If the Company has paid
7 more cash into the plan than the amount of NPPC recognized,
8 they have prepaid pension benefit cost, and there is an
9 expectation that this will be reversed in some future
10 period, with expense exceeding the contribution. The asset
11 is not a claim on investments that are inside the pension
12 trust. As described by Mr. English, plan assets may not
13 easily be removed by the Company due to ERISA law. The use
14 of plan assets is limited to providing benefits to plan
15 participants until all the promised benefits have been
16 delivered. The prepaid pension expense asset is a credit
17 for having given up cash in excess of the NPPC. That cash
18 did not get charged as an expense, so it represents the
19 exchange of one asset, cash, for another asset, the prepaid
20 pension expense.

21 Q. Why should this asset be included in the rate
22 base?

23 A. This asset represents a use of cash. It is a
24 consequence of providing a pension plan for employees,
25 following the required rules for funding the plan, and

1 recording the expense of the plan on the Company's books.
2 The pension plan is an important benefit for attracting and
3 retaining the employees needed to provide reliable electric
4 service to the Company's customers. In addition, the
5 prepaid pension expense was allowed as an asset in the
6 Company's last rate filing (Case No. IPC-E-94-5).
7 Q. Mr. English calculates Idaho Power's 15-year
8 average annual rate of return in its pension fund at 12.97%
9 and states that his calculated return was below the DJIA,
10 S&P 500 and the NASDAQ with returns of 13.89%, 15.02% and
11 21.6%, respectively. Mr. English opines that the investment
12 results of Idaho Power's pension fund are no better than the
13 performance of the general market. Do you agree with that
14 opinion?
15 A. I do not agree with that assessment. First
16 of all, Mr. English compares Idaho Power's pension fund
17 return against stock market index averages. This is not an
18 appropriate comparison, as a prudent pension fund normally
19 holds 35% to 40% in fixed income securities like bonds and
20 only 60% to 65% in stocks. Secondly, as a part of creating
21 our annual Actuary's Report Milliman USA calculates a rate
22 of return based on the change in fund assets from period to
23 period. Idaho Power's investment performance has
24 consistently been among the best of all of the pension plans
25 I review.

1 Q. Mr. Fowler, can you summarize your rebuttal
2 testimony?
3 A. Yes. Staff witness Mr. English advocates
4 making three downward adjustments to the Company's test year
5 pension expense and removing the entire prepaid asset from
6 rate base. I disagree with the reduction of $1,379,148
7 based on recalculating the 2003 pension expense at a higher
8 rate of return on plan assets of 9%, the removal of
9 $5,638,851 of the remaining FAS 87 Net Periodic Pension Cost
10 to equate FAS 87 pension expense to zero, and the removal of
11 the prepaid pension asset of $17,800,477 from rate base. I
12 do agree with Mr. English's reduction in pension expense in
13 the amount of $2,170,160 which results from not applying the
14 Company's 2003 Service Cost adjustment to the 2003 FAS 87
15 Net Periodic Pension Cost of $7,018,000.
16 Q. Does this conclude your rebuttal testimony in
17 this case?
18 A. Yes, it does.

BEFORE THE

IDAHO PUBLIC UTILITIES COMMISSION

CASE NO. IPC-E-03-13

IDAHO POWER COMPANY

EXHIBIT NO. 70

B. FOWLER

Actuarial Earnings Rate of Return
On Plan Assets

Actuarial Earnings Rate of Return on Plan Assets

Total Funds (1,032) (1,045)

	Mean		Changed Rate in Past Year	
	2002	2003	2002	2003
Corporate Funds (ex Unions)	8.9%	8.5%	24%	43%
Over $5 billion	9.1	8.6	20	59
$1-5 billion	8.9	8.6	31	51
$501 million-$1 billion	8.9	8.2	22	32
$500 million and under	8.8	8.4	19	34
Public Funds	8.0%	8.0%	9%	12%
State	8.0	8.0	6	7
Municipal	8.1	8.0	11	14
Over $5 billion	8.0	8.0	4	9
$1-5 billion	8.1	8.0	7	16
$501 million-$1 billion	8.0	8.1	16	6
$500 million and under	7.9	8.0	13	14
Union Funds	7.7%	7.8%	17%	10%
Total Funds	8.6%	8.3%	16%	26%

Note: Means exclude "None."

Exhibit No. 70
Case No. IPC-E-03-13
B. Fowler, IPCo
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