

BARTON L. KLINE ISB #1526  
MONICA B. MOEN ISB #5734  
Idaho Power Company  
P. O. Box 70  
Boise, Idaho 83707  
Telephone: (208) 388-2682  
FAX Telephone: (208) 388-6936

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IDAHO PUBLIC UTILITIES COMMISSION

Attorneys for Idaho Power Company

Street Address for Express Mail:

1221 West Idaho Street  
Boise, Idaho 83702

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION ) CASE NO. IPC-E-03-13  
OF IDAHO POWER COMPANY FOR )  
AUTHORITY TO INCREASE ITS INTERIM ) IDAHO POWER COMPANY  
AND BASE RATES AND CHARGES FOR ) POST-HEARING BRIEF  
ELECTRIC SERVICE )  
\_\_\_\_\_ )

General revenue requirement cases usually present numerous conflicting views and issues for resolution by the Commission. This case is no exception.

Heeding the Commission's admonition to judiciously manage the scope of post-hearing briefs, Idaho Power has limited this brief to four issues where the Company believes a legal brief could be of use to the Commission in making a final decision. These four issues and the legal concerns they present are summarized as follows:

**A. Income Taxes.**

1. Staff's proposal to depart from the use of actual tax rates to determine Idaho Power's income taxes violates IRS tax normalization requirements and is contrary to law because it is retroactive ratemaking.

2. Staff's recommendation to amortize the income tax deficiency payment in the test year over three years is inconsistent with prior Commission orders and is unreasonable.

**B. Annualizing Adjustments and Adjustments For Known and Measurable Changes.**

1. Staff and intervenor recommendations to exclude annualizing adjustments for two system reliability projects are contrary to law because such exclusion would deny Idaho Power a return on prudent investments currently used and useful in providing service to customers.

2. Staff and intervenor recommendations to exclude known and measurable system reliability investments from rate base are contrary to law because such exclusion would deny Idaho Power a return on prudent investments currently used and useful in providing service to customers.

**C. Brownlee-Woodhead Park.**

Staff's proposal to exclude improvements made to Woodhead Park from rate base is contrary to law because it denies Idaho Power a return on a prudent investment that is useful to customers and has been used since 1996.

**D. Micron Deferred Revenue Proposal.**

Micron's proposal that the Commission defer recovery of an approved revenue requirement without Idaho Power's consent is unreasonable and contrary to law because it would confiscate Idaho Power's property.

**A. Income Taxes.**

1. Idaho Power Company's Income Tax Calculations.

Idaho Power calculated its test year income tax expense using currently enacted statutory income tax rates. The Company's state income tax rate is the combination of Idaho at 5.9 percent, Oregon at 0.3 percent and all other states at 0.1 percent, for a total of 6.3 percent. The state income tax rates were determined by multiplying each state's current statutory income tax rates by their respective apportionment factor. For example, Idaho's statutory corporate income tax rate is 7.6 percent and was multiplied by Idaho Power's state of Idaho apportionment factor of 78 percent, the result being 5.9 percent. This calculation was followed for the other states in which Idaho Power files an income tax return, and is in conformance with the Commission's prior rulings on the method to be utilized for computation of state income taxes. This method is set forth in Case No. U-1006-185, Order No. 17499, dated August 20, 1982. In that Order the Commission stated:

(f) Idaho State Income Tax Rate. the Application used the 6.5% statutory Idaho state income tax rate to derive the revenue-to-income multiplier used to calculate the revenue deficiency. Tr. pp. 1059-1060; Ex. 7, p. 2, footnote 1. The Staff recommended using an effective Idaho state income tax rate of 4.8% to derive the revenue-to-income multiplier because it contended that Idaho state income taxes are not levied on the approximately 90% of Idaho Power Company's income

assigned to Idaho for ratemaking purposes, but only on the approximately 73% of Idaho Power's income assigned to Idaho for state income tax purposes. Tr. pp. 2464-2465. On rebuttal, the Company defended use of the 6.5% rate in the incremental tax multiplier because it argued that jurisdictional revenues would be taxed at the statutory rate and that use of a lower multiplier would under fund the increase. Tr. pp. 3177-3179.

We find that the 4.8% effective state income tax rate is the correct rate to be used in calculating the revenue-to-income multiplier. We find that this rate accurately reflects the Company's tax liability for revenues from its customers in Idaho and adopt it for that reason for rate setting purposes.

Idaho Power has used this required methodology since 1982 and especially in the present proceeding, with the only differences being the use of existing state statutory tax rates and the changes in the apportionment factors for the various states. The salient point remains, however, that Idaho Power computed state income taxes utilizing the existing *state statutory rates* applied to that portion of Idaho Power's revenue apportioned to each state.

The Company calculated its test year federal income tax expense using the current statutory federal income tax rate of 35 percent. In order to account for the allowable federal tax deduction for state income taxes the federal percent was reduced to 32.795 (35 percent multiplied by 93.7 percent (100 percent of income – 6.3 percent for state taxes) = 32.795). The salient point again is that the Company utilized the existing *federal statutory rate* to compute federal income tax expense.

The Company then computed the net-to-gross multiplier for income taxes associated with the additional revenue that will be required in this proceeding. This computation uses the income tax rate calculations as set forth above. The computation is as follows: 100 percent of income - 6.3 percent of state taxes - 32.795 percent

federal taxes = 60.905 percent net income. The 1.642 net-to-gross multiplier is derived by dividing 1 by the resulting net income expressed as a decimal, i.e.,  $1/0.60905 = 1.642$ .

As acknowledged by Staff witness Holm, the income tax calculations using statutory rates is the method that traditionally has been followed by the Commission. Tr. at 1459-1460.

The Company also included in the test year, consistent with Order No. 17499 issued in Case No. U-1006-185 (1982), the federal tax deficiency payments of \$2,942,924. Mr. Ripley, in his direct rebuttal testimony, set out the pertinent provisions of Order No. 17499. Tr. at 2947-2948. Clearly and unambiguously, the Commission ruled in that proceeding that the Company could recover as a tax expense any deficiencies actually paid in the test year.

## 2. Staff's Adjustments To Idaho Power's Income Tax Calculations.

Staff proposes to abandon the traditional method of computing income tax expense and the resulting net-to-gross multiplier for computing the Company's additional revenue requirement by rejecting the use of current statutory income tax rates. In their place, Staff proposes (apparently for this case only) to use what Staff terms as an average effective tax rate. As explained by witness MacMahon for the Company, Staff has proposed to compute Idaho Power's income tax expense by using an average ratio of Idaho Power's actual above-the-line income tax expense as a percentage of actual pre-tax book income for each of the past five years added together and then divided by five. Tr. at 2907-2909.

Specifically, Staff has developed a hybrid income tax rate concept by taking each of the last five years including the test year and averaging the ratio of total income tax expense (current tax, deferred tax, and ITC) for each year over the total pre-tax book income for each year. The resulting ratio for each year was added up and divided by five to arrive at an average ratio that applied to the previous five years. This average ratio was applied to regulatory pre-tax income and labeled "current tax".

Staff's hybrid ratio was used to value the current change in normalized temporary differences for deferred income tax expense, disregarding the fact that the beginning balance in accumulated deferred income taxes was previously established using statutory tax rates.

The result of Staff's computation was an average federal income tax rate of 25.24 percent and an average state income tax rate of 5.62 percent, for a total average composite rate of 30.86 percent. As conceded by Staff witness Holm, the use of Staff's five-year average was motivated by the non-reoccurring deduction taken on the 2001 income tax returns with the resulting tax refund paid in 2002. Tr. at 1471, LL. 6-7. As noted by witness MacMahon, when the non-reoccurring deduction was removed from Staff's five-year "average," the computation came out to 39.19 percent, which is extremely close to Idaho Power's federal and state combined statutory income tax rate of 39.10 percent. Tr. at 2909-2911.

Additionally, this hybrid ratio was also used by Staff to compute the net-to-gross tax multiplier to set the new revenue requirement to a pre-tax revenue value, without regard to the actual income taxes the Company will pay on these new revenues.

Finally, Staff has reduced Idaho Power's 1998-2000 Internal Revenue Service deficiency payment of \$2,942,924 included in the test year income tax expense to \$982,395 and added a state deficiency payment of \$55,846 on the theory that the payments should be amortized over a three-year period, totally ignoring the requirements of Order No. 17499.

3. The Capitalized Overhead Cost Method Reduced Revenue Requirement By Approximately \$5 Million in the Test Year.

Staff witness Holm acknowledged that Idaho Power calculated its income tax expense for test year 2003 using the capitalized overhead costs method that Staff had questioned for the tax years 2001 and 2002. Staff witness Holm stated that "[T]his tax benefit of approximately \$5 million provides a benefit to customers during 2003 and is included in the test year." Tr. at 1436, LL. 13-22. Idaho Power witness MacMahon agreed and stated ". . . the 2003 test year regulatory income tax expense includes a total system \$14.3 million flow-through tax deduction. This deduction reduced current income tax expense by \$5.6 million. Had Idaho Power not initiated the method change, customers would not be realizing this benefit in the 2003 test year." Tr. at 2905, L. 22 - Tr. at 2907, L. 1.

4. The Staff's Proposal Violates the Normalization Requirements of the Internal Revenue Code and the utilization of Staff's Proposal Would Result In Denial of Accelerated Depreciation.

As stated by Idaho Power witness MacMahon, there are two distinct methods of computing income tax expense in a regulatory proceeding:

(1) normalization, and (2) flow-through. It should be noted that a majority of the states use the normalization method, whereas the Idaho Public Utilities Commission has required Idaho Power to be a “flow-through” company. In making this observation, Idaho Power is not rearguing whether normalization or flow-through is more appropriate, but simply pointing out that the Idaho Public Utilities Commission has decided that Idaho Power will be required to flow through tax benefits. The only exceptions to this flow-through methodology are the temporary differences created by federal accelerated and bonus depreciation and contributions-in-aid-of-construction (CIAC) which are excluded from flow-through treatment by federal law (Internal Revenue Code §168(f)(2) and Notice 87-82 respectively). A violation of the normalization requirements in the federal tax law would trigger a repayment obligation to the federal government of previously accumulated deferred income taxes and the forfeiture of accelerated tax depreciation methods to Idaho Power in the future. Accordingly, the Company has provided for deferred income taxes on these items in its regulatory income tax expense at the federal statutory income tax rate. The Commission has not normalized these items for state of Idaho income tax purposes and the state-effect of the adjustment is flowed through to current income tax expense. Tr. at 2900, L. 15 - Tr. at 2901, L. 5.

As was pointed out by witness MacMahon, Staff’s proposal to utilize a hybrid tax ratio not tied to the currently enacted statutory federal income tax rate causes a violation of the required normalization procedures. This is because when Staff utilizes

an income tax rate which is substantially below the currently enacted statutory tax rate, this, in effect, causes a flow through of the tax benefits on those items which, as stated above, are excluded from flow-through treatment.

5. The Internal Revenue Service Has Indicated That Proposals Similar To Staff's Are Violations of the Federal Tax Normalization Requirements.

There have been various proposals advanced in utility regulatory proceedings which attempted to avoid triggering a violation of normalization requirements in the federal tax law. The Internal Revenue Service has consistently ruled that such proposals, whether directly or indirectly affecting the calculations of income tax expense, would not be accepted.

For example, in Private Letter Ruling 8525156, the Internal Revenue Service considered whether it was appropriate to use a consolidated group's effective tax rate, which was lower than the statutory rate, to determine the current and deferred income tax expense for ratemaking purposes of the group's regulated utility member.

The Service held that use of the lower effective tax rate would result in an insufficient amount of deferred federal tax for the utility's difference between straight line and accelerated depreciation. The actual federal income tax liability is not determined by an effective rate. Normalization accounting requires the use of the federal income tax rate provided in section 11(b) of the Code. Also, the Service stated, "[B]y introducing variables other than the difference between the deductions for accelerated and straight line depreciation, the use of an effective tax rate may produce

a deferred tax adjustment that will be inadequate to meet normalization requirements.” This was a departure from the consistency requirements of normalization.

After determining that using an effective tax rate resulted in the utility not being in compliance with the normalization requirements of the Code for its depreciation difference, the Service went on to say “... it follows that it will be equally inappropriate to use the effective tax rates to compute its current income tax expense for ratemaking purposes. Because deferred tax expense and current tax expense are simply components of the total tax expense, when the use of an effective tax rate to compute deferred tax would violate normalization requirements, its use to determine current tax expense is no less objectionable. Such use of the consolidated effective tax rate achieves through current tax expense a cost of service reduction that would violate normalization requirements if achieved through a reduction of deferred tax expense, and the effect is the same as if there was a partial flow-through of the benefits of accelerated depreciation as a result of deferring less than all the difference between straight line and accelerated depreciation. *By either view, the use of consolidated effective tax rates in the determination of deferred tax expense or current tax expense will cause Subsidiary to fail to comply with the normalization provisions of the Code and the regulations thereunder.*” (emphasis added)

The effect of Staff’s proposal would result in the same conclusion reached in the above Ruling. If accepted, Staff’s proposal will cause a normalization violation. The result of such a violation to Idaho Power and its customers will be the loss of accelerated depreciation (thereby increasing current income taxes), a repayment obligation of the accumulated deferred income taxes related to accelerated

depreciation, and a reduction in the deferred tax liability balance (which will increase rate base).

6. Even Assuming Staff's Proposal Would Be Approved, the Result Would Be A Dramatic Change In the Reserve For Deferred Income Taxes Which Would Cause A Sharp Increase In Rate Base.

Mr. Holm reduced deferred income tax expense by using Staff's five-year hybrid tax ratio on the current year change to temporary differences, while disregarding the fact that the beginning balance in accumulated deferred income taxes had been recorded using statutory income tax rates. Setting aside the resulting adverse impact of triggering a normalization violation, another deficiency in the Staff's proposal is that the accumulated deferred income taxes would need to be recomputed using the five-year hybrid tax ratio. Following Staff's proposal, the recomputed reserve for deferred income taxes would increase the Company's rate base by approximately \$53 million as the net deferred tax liability balance would drop due to the application of the lower rate. Tr. at 2917, LL. 5-18.

7. Staff's Proposal Violates the Retroactive Ratemaking Requirement, Since Staff Is Essentially Taking Into Account A Past Event To Project Future Income Tax Expense.

It is clear that Staff is using a past event which will not reoccur to determine the income tax rate it proposes to use in computing Idaho Power's future income tax expense and resulting revenue requirement. The Idaho Supreme Court and

this Commission have always refused to base future rates on past events. Even accepting for the sake of argument Staff's assertion that Idaho Power received a windfall in 2002 as a result of the capitalized overhead method change, Staff cannot now go back in time and obtain the perceived benefits from this change. Such an attempt is clearly retroactive ratemaking, which this Commission has always stated it cannot and would not do. In addition to the Idaho Supreme Court opinion quoted by Mr. Ripley in his testimony (*Utah Power & Light v. Idaho Public Utilities Commission*, 685 P.2d 276, 107 Idaho 47 (1984)), the Company would call to the attention of the Commission the Commission's discussion in the last general rate proceedings concerning the Pacific Hide clean-up expense (Order No. 25880 issued in Case No. IPC-E-94-5). There the Commission, at pages 8 and 9, ruled that it would not go back in time to review an event which had occurred in the past to set rates for the future. This is precisely what Staff is recommending when it utilizes its proposed hybrid tax ratio to determine income tax expense for the future.

8. Staff's Recommendation To Amortize the Income Tax Deficiency Payment Made In the Test Year Over Three Years Is Inconsistent With Prior Commission Orders and Is Unreasonable.

As previously stated, Commission Staff, while not challenging the amount of \$2,942,924 included in the test year, recommends that amount be amortized over a three-year period. As previously stated, this proposal is directly in conflict with Commission Order No. 17499, which provided that any income tax deficiency payments in the test year would be included in the Company's revenue requirement. A deficiency

amount was included in the Company's revenue requirement in the proceeding that resulted in Order No. 17499. The trade-off was that the Company would not be permitted to recover any income tax deficiency payments that it made in a non-test year. As pointed out by witness MacMahon, the Company paid and absorbed, pursuant to Commission Order No. 17499, income tax deficiency payments that were not in a test year, i.e., 1993-1995, paid in 1998, and 1996-1997 paid in 2000.

9. Summary.

The Commission should not accept Staff's income tax proposals and should compute Idaho Power's 2003 test year income tax expense using the current statutory income tax rates as provided by the Company. Choosing not to use the current statutory income tax rates because of a non-reoccurring tax deduction from 2001 is retroactive rate making. Additionally, failing to use current statutory income tax rates will result in a normalization violation of the Internal Revenue Code, which would adversely affect Idaho Power's cash flow and would increase the Company's revenue requirement. Also, the current statutory income tax rates should be used to compute the net-to-gross tax multiplier as those rates properly reimburse Idaho Power for the actual income taxes it will pay on the new revenue dollars. Staff's proposed net-to-gross tax multiplier leaves the Company far short of its actual income tax liability. Finally, Idaho Power's income tax deficiency payment should be allowed in full in accordance with prior Commission order and practice.

**B. Annualizing Adjustments and Known and Measurable Changes.**

The Commission Staff and Micron Technology, through witnesses Leckie and Peseau, respectively, urge the Commission to reject Idaho Power's proposed inclusion in its rate base of: (1) annualizing adjustments for two large system reliability projects that are currently used and useful; and (2) known and measurable changes to the test year rate base attributable to several large transmission projects that are currently used and useful and one project that will be placed in service prior to the effective date of rates set in this case.

For both the annualizing adjustments and the known and measurable changes, the Company has satisfied the legal requirements for inclusion of these system reliability projects in rate base. In *Utah Power & Light Co. v. Idaho Pub. Util. Com'n*, 102 Idaho 282, 629 P.2d 678 (1981), the Idaho Supreme Court held that the Commission should include in the rate base all items which are proven with reasonable certainty to be justifiably used by the utility in providing services to its customers. (*Utah Power & Light Co.*, 102 Idaho 282 at 284).

In the *Utah Power & Light* case the Court elaborated as follows:

Test year data should be adjusted for known and measurable changes where the changes are shown to be reliable and certain. *E. g.*, *Citizens Utility Co. v. Idaho Public Utilities Comm'n*, 99 Idaho 164, 579 P.2d 110 (1978); *Agricultural Products v. Utah Power & Light Co.*, 98 Idaho 23, 557 P.2d 617 (1976). The Commission should include in the rate base all items which are proven with reasonable certainty to be justifiably used by the utility in providing services to its customers. *Citizens Utility Co. v. Idaho Public Utilities Comm'n*, *supra*. (*Utah Power & Light*, 102 Idaho 282, at 284)

Idaho Code § 61-502A adds further clarification regarding the standards that the Commission must apply in considering whether a particular investment can be

included in the utility's rate base. Idaho Code § 61-502A prohibits the Commission from including investment in rate base which is not currently used and useful. More specifically, Idaho Code § 502A provides as follows:

**61-502A. Restriction on rates authorizing return on property not providing utility service.** -- Except upon its finding of an extreme emergency, the commission is hereby prohibited in any order issued after the effective date [February 29, 1984] of this act from setting rates for any utility that grants a return on construction work in progress (except short-term construction work in progress) or property held for future use and *which is not currently used and useful in providing utility service*. As used in this section, short-term construction work in progress means construction work that has begun and will be completed in not more than twelve (12) months. Except as authorized by this section, any rates granting a return on construction work in progress (except short-term construction work in progress) or property held for future use are hereby declared to be unjust, unreasonable, unfair, unlawful and illegal. When construction work in progress is excluded from the rate base, the commission must allow a just, fair and reasonable allowance for funds used during construction or similar account to be accumulated, computed in accordance with generally accepted accounting principles. (Emphasis added)

The Company has presented substantial, competent evidence in this case demonstrating that the facilities for which it is seeking (1) an annualizing adjustment, or (2) inclusion as a known and measurable change, are all prudent investments that are currently used and useful.<sup>1</sup> As such, these system reliability projects meet all of the tests required for inclusion in rate base described by the Idaho Supreme Court in *Utah Power & Light*, supra, and Idaho Code § 61-502A.

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<sup>1</sup> The Goshen 345-kV capacitor bank replacement project has been installed and is currently undergoing final commissioning and testing. The expected "in-service" date is May 15, 2004, well before the expected effective date of the rates to be set in this proceeding.

1. Staff And Intervenor Recommendations To Exclude Annualizing Adjustments For Two System Reliability Projects Are Contrary To Law Because Such Exclusion Would Deny Idaho Power A Return On Prudent Investments That Are Currently Used And Useful In Providing Service To Customers.

The two projects for which the Company is seeking an annualizing adjustment are both large system reliability projects. The first, known as the Bridger Unit No. 3 rewind project, involves an approximately \$6.6 million investment in the Jim Bridger coal-fired generating plant in Wyoming. (Exhibit 21) The Jim Bridger Plant is approximately thirty years old, and the Bridger Unit No. 3 rewind project was performed to ensure that Unit No. 3 specifically, and the Jim Bridger Plant as a whole, would continue to operate reliably at the levels included in the Company's power supply model used in this case. Tr. at 2788, LL. 12-15.

The second annualizing adjustment is an increase of approximately \$13 million to transmission plant for the Brownlee-Oxbow 230-kV transmission system. (Exhibit 21) The Brownlee-Oxbow transmission project was constructed to allow Idaho Power to fully integrate all of its existing Hells Canyon Complex generation into its system during the peak summer months. Like the Bridger Unit No. 3 rewind project, the Brownlee-Oxbow transmission line project was closed to plant in the fourth quarter of 2003 and has been used and useful, providing service to customers ever since. Tr. at 2789, LL. 8-17.

By making an annualizing adjustment for these two projects, the Company has included both the Bridger Unit No. 3 rewind project and the Brownlee-Oxbow transmission project in the Company's rate base during the entire period of the 2003

test year. Staff and Micron argue that these two projects should be included in rate base, but only for those months in 2003 after the two projects were closed to plant. Of course, by doing that, Staff and Micron limit the amount of investment in these two projects upon which the Company will be entitled to earn a return in the future.

2. Idaho Power's Annualizing Adjustments Properly Match Expense and Revenue.

Staff and Micron's recommended disallowance of annualizing adjustments for the Bridger Unit No. 3 rewind project and the Brownlee-Oxbow transmission project are not based on an assertion that the two projects are not currently providing benefit to customers. In fact, Staff witness Leckie acknowledges that these two projects are both prudent investments and are currently used and useful. Tr. at 1581, LL. 1-3.

The argument advanced by both Staff and Micron against the annualizing adjustment is that the Company has not matched the *expense* associated with an annualizing adjustment and the *revenue* attributable to the facility for which an annualizing adjustment is sought. Idaho Power agrees that both this Commission and the Idaho Supreme Court have indicated that in the case of new production plant that will produce additional kWh's for sale, an adjustment to revenues as well as expense is necessary.

However, both this Commission and the Idaho Supreme Court have distinguished between investment in new production plant, which will produce additional kWh's for sale, i.e., revenue, and plant investments that, by their nature, do not produce revenue. In the case of non-revenue producing investment, an adjustment to revenues is not necessary -- expenses and revenues are already properly matched. In this case

specifically, revenues and expenses are properly matched because neither the Bridger Unit No. 3 rewind project nor the Brownlee-Oxbow transmission project are revenue producing.

In Order No. 13448 issued in Case No. U-1009-84 on September 29, 1977 (22 PUR.4th 357), the Commission considered Utah Power & Light Company's (UP&L's) proposed inclusion of two "known and measurable" adjustments to rate base. The first requested adjustment was for the Huntington #2 coal-fired generating unit. The second was for investment in UP&L's Deer Creek coal mine. In Order No. 13448 (22 PUR 4th, p. 357), the Commission considered the identical issue presented by Staff and Micron in this case. Staff urged that UP&L's proposed inclusion of Huntington #2 and the Deer Creek mine as known and measurable changes should be rejected because they were revenue-producing items and it would therefore be necessary to make adjustments to the test year revenues corresponding to the addition in rate base. The Commission agreed with Staff on Huntington #2. Addressing the Deer Creek mine adjustment, the Commission stated:

*The Deer Creek coal mining property is a much closer question. On rebuttal, the applicant pointed out that the coal mine is not a revenue-generating property as such, and its inclusion as a known and measurable adjustment to rate base would not result in a mismatch of test year revenues and expenses. (Emphasis added) (Order No. 13448, PUR.4th 22 357, 358)*

In Order No. 13448 the Commission clearly acknowledged the distinction between non-revenue producing investment and generating plant investment.

The Commission eventually rejected the inclusion of the Deer Creek coal mine investment because it did not believe that UP&L had adequately demonstrated that the Deer Creek coal mine was used or useful. UP&L appealed the Commission's

decision not to include both Huntington #2 and the Deer Creek mine investment as known and measurable changes in the test year. In *Utah Power & Light Co. v. Idaho Pub. Util. Com'n*, 102 Idaho 282, 629 P.2d 678 (1981), the Supreme Court overturned the Commission's decision and ordered the Commission to include both Huntington #2 and the Deer Creek mine investment in UP&L's rate base as known and measurable changes.

At this juncture it's important to acknowledge that Idaho Code § 61-502A became law several years after the above-referenced *Utah Power & Light Co.* case. However, Idaho Code § 61-502A is not a consideration in this instance. No party to this case has asserted that either the Bridger Unit No. 3 rewind project or the Brownlee-Oxbow 230-kV transmission line project is not used and useful. Because these two projects are used and useful, the proscription on the inclusion of construction work in progress and plant held for future use contained in Idaho Code § 61-502A is not applicable. Staff and Micron did not object to annualizing adjustments for the Bridger Unit No. 3 rewind project or the Brownlee-Oxbow 230-kV line project because the projects were not used and useful. Their concern was the proper matching of expenses and revenues. As demonstrated in this case, expenses and revenues *are* properly matched and do not present an issue in this proceeding.

As noted in the testimony of Idaho Power witness Obenchain, both the Bridger Unit No. 3 rewind project and the Brownlee-Oxbow transmission line project are large investments the Company is making in equipment that will not produce additional revenue. Tr. at 2788, LL. 6-15. The Bridger No. 3 rewind project will not increase the generating capacity of the Jim Bridger plant. The Bridger No. 3 rewind project's only

goal was to increase plant reliability. The Bridger No. 3 rewind project will not produce more revenue, but will make it more likely that the Jim Bridger Plant will actually be able to produce the level of generation (and revenue) that is already included in the Company's test year data.

The Brownlee-Oxbow transmission line presents the identical situation. The Brownlee-Oxbow transmission line investment does not increase revenues. It will not add additional wheeling revenue or decrease power supply expense below the levels contained in the test year data. Tr. at 2802, LL. 2-10. Its construction only increases the likelihood that the Company will actually be able to realize all of the revenue attributable to the Hells Canyon production plant already included in the test year data.

Neither Staff nor Micron presented any evidence that there would be any additional revenues or expense savings associated with the two projects. In support of their position, they assert the general proposition that utilities don't make investments unless they expect to receive additional revenues associated with those investments. That generalization is accurate only when considering *generating* plant investment that allows the utility to produce more energy and, thus, the potential for achieving additional revenues.

Utilities routinely make investments in transmission and other reliability-related plant that does not produce more energy or create new revenues or reduce expense. Idaho Power is required by law to provide adequate, efficient, just and reasonable electric service to its customers. Idaho Code, §61-302. The Company regularly makes investments in transmission and other non-production plant simply

because the existing facilities are reaching the limit of their capacity, and failure to invest in additional facilities could result in degraded service to existing customers. Micron, of all of Idaho Power's customers, should have the greatest appreciation that Idaho Power often makes investments solely for system reliability purposes, not to generate additional revenue.

In his cross-examination of Mr. Obenchain, counsel for Micron attempted to equate the construction of transmission and substation facilities in anticipation of load growth with the receipt of additional revenues. Of course, it is not. While the Company does its best to prioritize transmission and substation facility construction to anticipate projected load growth, it must make system reliability decisions and investments without any certainty that load growth will continue at expected levels or, in fact, occur at all. Staff and Micron's arguments fail to recognize the reliability aspect of Idaho Power's construction planning process.

3. Recommendations To Exclude Known and Measurable System Reliability Investments From Rate Base Are Contrary To Law Because Such Exclusion Would Deny Idaho Power A Return on Prudent Investments Currently Used and Useful In Providing Service To Customers. The arguments both supporting and contesting Idaho Power's annualizing adjustments are identical to the Company's proposal to include known and measurable investments in this case. The investments the Company included in its test year data as known and measurable changes, are all for transmission facilities required to maintain service reliability and provide adequate service. Tr. at 2795, LL. 20-24.

Specifically, the known and measurable investments consist of the Star substation and related transmission facilities and feeder lines, the Valley View substation and related transmission facilities and feeder lines, the Midrose substation and related transmission facilities and feeder lines, the Goshen 345-kV series capacitor bank replacement project and a portion of the Oxbow-Brownlee 230-kV project, for a total investment of approximately \$18.4 million. The Star, Valley View, Midrose and Oxbow-Brownlee projects are all completed and currently used and useful serving customer loads. The Goshen 345-kV series capacitor bank project involves the replacement of a thirty-year old 345-kV series capacitor bank located on the east side of Idaho Power's main transmission system. This capacitor bank protects the Jim Bridger Plant and allows the Company to safely integrate the Jim Bridger Plant generation onto its system and the system of PacifiCorp. Its installation had to be timed to coincide with low-load periods on both the Idaho Power and PacifiCorp systems. The Goshen 345-kV replacement capacitor bank has been installed and the expected in-service date is May 15, 2004, well prior to the expected June 1, 2004 effective date for the rates to be set in this proceeding. All of these transmission investments have been made to improve system reliability for current customers and will provide no new revenue to the Company. Tr. at 2795, LL. 20-24.

No party to the proceeding questioned that the above-described projects were required for the Company to continue to provide adequate service to existing customer loads. No party to the proceeding provided any evidence that the above-described transmission projects are not currently used or useful. No party provided any evidence that the above-described transmission projects would provide any additional

revenue. Staff witness Leckie admitted that the transmission projects the Company has included as known and measurable changes were examples of a utility constructing facilities to ensure reliability as compared to achieving additional revenue. Tr. at 1593, LL. 11-13.

The Idaho Supreme Court in the previously cited *Utah Power & Light* case described the requirement for adjusting test year data to include known and measurable changes. The Court indicated that if the Company demonstrates with reasonable certainty that the investment will be used by the utility to provide service to its customers within a reasonable period of time, the Commission must include the items in rate base. See *Utah Power & Light Company v. Idaho Pub. Util. Com'n*, 102 Idaho 282, 284, 629 P.2d 678 (1981); *Citizens Util. Co. v. Idaho Pub. Util. Com'n*, 99 Idaho 164, 579 P.2d 110 (1978).

In this proceeding, Idaho Power presented substantial competent evidence that the transmission projects it has included as known and measurable changes are prudent investments that are either currently used and useful, or in the case of the Goshen 345-kV capacitor bank replacement project, will be used and useful before rates are set in this case. No party has presented any evidence to the contrary. As in the case of the annualizing adjustments, the only real objection presented by any party was the potential mismatch between expenses and revenues.

As in the case of the annualizing adjustments, Idaho Power presented evidence in this case that none of these projects are revenue-producing projects and as such, expenses and revenues are properly matched. Tr. at 2795, LL. 20-24. As in the case of the annualizing adjustments, Staff and Micron make the same general assertion

that no utility makes an investment without an expectation of revenues. As in the case of the annualizing adjustments, this argument fails to recognize the reliability aspect of Idaho Power's construction planning process. Idaho Power will not repeat its prior arguments on its legal obligation to provide adequate, reliable service. (Idaho Code § 61-302.)

4. Summary. In considering whether to include the above-described annualizing adjustments and known and measurable investments in Idaho Power's test year data, the Commission must focus on the following facts: (1) All of these projects are currently used and useful and serving customer loads; (2) All of these investments were prudent and made to satisfy the Company's statutory obligation to provide adequate, reliable service; (3) None of these projects produce additional revenue; and (4) Failure to include these reliability-enhancing investments as annualizing adjustments and known and measurable changes means that the Company will earn no return on this investment, even though all of the facilities will be in place serving customer loads for years to come.

Based on those facts, the Company's proposed annualizing adjustments and known and measurable changes fully comply with the Idaho Supreme Court test for inclusion in rate base as described in the *Utah Power & Light* and *Citizens Utilities* cases and are in full accord with Idaho Code § 61-502A.

**C. Brownlee-Woodhead Park.**

1. Staff's proposal to exclude improvements made to Woodhead Park from rate base is contrary to law because it denies Idaho Power recovery of a return on a prudent investment that is useful to customers and has been used since 1996.

In 1996, in compliance with the requirements of Idaho Power's Federal Energy Regulatory Commission (FERC) license for the Hells Canyon Complex (FERC Project 1971), Idaho Power completed construction of substantial improvements at Woodhead Park on Brownlee Reservoir. All of the upgraded facilities at Woodhead Park have been utilized by the public since that time. Tr. at 630, LL. 23-24. In his testimony, Mr. Prescott describes in considerable detail the extensive use that the public makes of Woodhead Park. Tr. at 631, LL. 2-6. Staff, through witness Leckie, recommends that the Commission disallow a return on the Company's \$7.5 million investment in the improvements made to Woodhead Park and that this amount be deferred and included in the Hells Canyon Complex relicensing costs for recovery in the future. Tr. at 1561, L. 24 and p. 1562, LL. 1-5.

Staff makes this recommendation in spite of the fact that Woodhead Park is an integral part of the Company's Hells Canyon hydroelectric facility, which facility is currently used and useful. Tr. at 3159, LL. 3-4. The license for the Hells Canyon Project is subject to the jurisdiction of the FERC, and the FERC has approved all improvements the Company made to Woodhead Park. Tr. at 3159, LL. 4-6. Witness Leckie acknowledges that the Company's existing license requires that Idaho Power optimize and provide adequate recreational opportunities for the public. Tr. at 1562, LL. 9-12. Staff does not contend that the improvements to Woodhead Park are imprudent.

Tr. at 1594, L. 20. Staff does not contend that the improvements to Woodhead Park are not used and useful. Tr. at 1594, L. 9. Staff's only contention is that Woodhead Park will be a factor in the Hells Canyon relicensing process, and as a result, recognition of the investment in Woodhead Park improvements should be deferred until approximately 2008 when the larger investment the Company is currently making in Hells Canyon relicensing costs is presented to the Commission for inclusion in the Company's revenue requirement. Tr. at 1596, LL 9-13. Staff adds insult to injury by arguing that the Company should continue to *depreciate* the investment in Woodhead Park. Tr. at 1596, L. 17. Should the Commission accept Staff's recommendation on this issue, the Woodhead Park investment amount will continue to decline due to depreciation so that in 2008, when the Company requests inclusion of Hells Canyon relicensing costs, the amount attributable to Woodhead Park will be less and the Company will *never* have earned its authorized rate of return on that investment over that time period. In essence, Staff argues that it is appropriate for the Company to depreciate its investment in Woodhead Park improvements from 1996 until approximately 2008, but it is not appropriate for the Company to earn a return on its investment over the same time period. Such a result is clearly unfair and confiscates Idaho Power's property.

The Idaho Supreme Court, in *Utah Power & Light Co. v. Idaho Pub. Util. Com'n*, 105 Idaho 822, 673 P.2d 422 (1983), describes what makes up a utility "rate base." Quoting *Intermountain Gas v. Idaho Public Utilities Commission*, 97 Idaho 113, 116, 540 P.2d 775, 778 (1975), the Court defined "rate base" as follows: "The rate base consists of the capital invested in the utility upon which the company is entitled to

a fair and just return. Citing *Federal Power Com'n v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944). Quoting *Citizens Util. Co. v. Idaho Public Util.*, 99 Idaho 164, 169, 579 P.2d 110, 115 (1978), the Court went on to describe rate base as follows:

A utility's "rate base" represents the original cost minus depreciation of all property justifiably used by the utility providing services to its customers. Utilities are allowed to charge customers rates which will yield a certain percentage return on the utility's total investment.

Staff bases its recommendation to deny rate base treatment for the Woodhead Park investment on the fact that the investment in Woodhead Park will improve the Company's chances to relicense the Hells Canyon Project. Tr. at 1596, LL. 9-13. While Idaho Power is somewhat baffled why it should be penalized for taking steps today that will improve its chances to relicense the Hells Canyon Complex, the reality is that the Woodhead Park improvements were performed primarily to satisfy *current* FERC license requirements. Tr. at 631, LL. 12-14.

The Company has presented unchallenged evidence that the investment and improvements at Woodhead Park were made to comply with the current FERC license for the project. Tr. at 628-31. If there is a secondary benefit by way of an increased chance of relicensing, so much the better. No party in this proceeding argues that the investment in Woodhead Park improvements was not made at least partially to satisfy current license requirements. Tr. at 1596.

2. Summary. In the final analysis, the Company has presented substantial competent evidence by way of the unchallenged testimony of Ric Gale that: (1) the Woodhead Park investment property has been used by Idaho Power to provide

services to its customers since 1996. Tr. at 3159, L. 3; (2) the investment in improvements in Woodhead Park are an integral part of the Company's Brownlee Hydroelectric facility and subject to the Company's FERC license for the Hells Canyon project. Tr. at 3159, LL. 3-6; (3) the FERC has approved the improvements to the park. Tr. at 3159, LL. 6-7; (4) the investment is prudent and is used and useful now; and (5) the investment was undertaken in compliance with the current license for the Hells Canyon Project. Tr. at 3159, L. 3.

To deny shareholders a return on an investment that is prudent, currently used and useful and currently dedicated to public convenience and necessary is unreasonable and confiscates Idaho Power's property.

**D. Micron's Deferred Revenue Proposal.**

1. Nearly all of the parties to this proceeding advocated increasing rates charged to the irrigation class to alleviate a long-standing failure on the part of the irrigation class to contribute sufficient revenues to cover the cost of providing service to the irrigation class. Throughout the case, this shortfall between the cost of service and the revenues contributed by the irrigation class was referred to as the "irrigation subsidy." A number of parties, including the U.S. Department of Energy, Micron Technology, AARP, United Water and Kroger, all proposed that the Commission establish a specific time-line over which the "irrigation subsidy" would be eliminated. Micron Technology went even further and proposed a formal regulatory accounting approach to provide that the shortfall under Micron's proposal would be made up.

Under Micron's proposal, the irrigation class rates would continue to fall short of full recovery of its cost of service. But, rather than charging the other customer classes a higher rate to make up the shortfall, Micron proposes that (1) the other customer classes only cover their cost of service, and (2) the resulting revenue shortfall be deferred and treated as a regulatory asset for recovery in future irrigation rates. Of course, the upshot of Micron's proposal would be that the rates approved for Idaho Power in this case will not produce the authorized revenue requirement approved by the Commission. While Idaho Power, like all the other participants in the case, is uncomfortable with the continuing disparity between the cost of providing service to the irrigation class and the revenues received from that class, Idaho Power does not believe that Micron's proposal is a fair or appropriate way to address that problem.

It is basic "black letter" law that Idaho Power, as a regulated utility, is legally entitled to recover its prudently incurred expenses and earn a return on the value of its property justifiably used in providing service to its customers. *Bluefield Water Works Improvement Co. v. West Virginia Pub. Serv. Com'n*, 262 U.S. 679, 692, 43 S.Ct. 675, 67 L.Ed. 1176 (1923), *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S.Ct. 281, 88 L.Ed. 333 (1944), *Utah Power & Light Co. v. Idaho Pub. Util. Com'n*, 105 Idaho 822, 673 P.2d 422 (1983), *Citizens Utility Co. v. Idaho Pub. Util. Com'n*, 99 Idaho 164, 579 P.2d 110 (1978). In order to recover its prudently incurred expenses and earn a return, the Commission establishes the Company's authorized revenue requirement and approves rates that will allow the Company to recover the revenue requirement. If Micron's proposal is adopted by the Commission, Idaho Power will not be allowed to charge rates that will recover all of the revenue requirement authorized by the

Commission. The rates authorized will *ab initio* be insufficient to fund the authorized revenue requirement. Deferral of a portion of an approved revenue requirement in anticipation that the deferred revenue will be funded by future customers is a refusal to put in place rates sufficient to fund Idaho Power's approved revenue requirement. Deferral of a revenue requirement, even if it is coupled with a regulatory asset, is not the same as setting rates which will fund the Commission approved revenue requirement.

2. The Commission cannot intentionally set rates that are insufficient to recover a utility's authorized revenue requirement.

Idaho Code § 61-502 provides that:

Whenever the commission, after hearing and upon its own motion or on complaint, shall find that the rates, fares, tolls, rentals, charges or classifications, or any of them. . . are unjust, unreasonable, discriminatory or preferential, or in anywise in violation of any provision of law, *or that such rates, fares, tolls, rentals, charges or classifications are insufficient, the commission shall determine the just, reasonable or sufficient rates, fares, tolls. . . to be thereafter observed and in force and shall fix the same by order as hereinafter provided. . .* (Emphasis added)

In *Agricultural Prod. v. Utah Power & Light Co.*, 98 Idaho 23, 557 P.2d 617 (1976), the Idaho Supreme Court held that: "When the Commission finds that rates charged are unjust, unreasonable, discriminatory or preferential, or are insufficient, it must set those rates at a just and reasonable level." Idaho Code § 61-502. *Agricultural Prod. v. Utah Power & Light Co.*, 98 Idaho 23, 25 (1976).

The New Mexico Supreme Court considered a similar situation in 1982. In *General Tel. Co. of the Southwest v. Corporation Com'n*, 98 New Mexico 749, 652 P.2d 1200 (1982), the New Mexico Supreme Court ruled that when the State

Corporation Commission establishes a revenue deficiency and then subsequently sets rates that will not allow the utility to recover that revenue deficiency, such a result is unlawful. Quoting a number of cases from multiple jurisdictions, the New Mexico Supreme Court stated: "We agree with the rationale stated in the foregoing cases, that a regulatory commission has no authority to deny an increase in rates in an amount which it has first found to be just, fair and reasonable, by means of imposing a subsequent penalty for poor or inadequate service." *General Tel. of the Southwest v. Corporation Com'n*, 98 New Mexico 749, 754, 652 P.2d 1200, 1205 (1982).

While the fact situation in the New Mexico case is certainly different than the facts presented in this case, the underlying principle is analogous. Once the Commission has established a revenue requirement, it is obligated to set rates that will allow the utility the opportunity to earn that revenue requirement. Ordering the utility to defer a portion of its revenue for recovery some time in the future is conceptually no different than establishing a revenue requirement and then consciously setting rates that will not allow the utility to recover that revenue requirement to penalize the utility.

Idaho Power believes there is a critical distinction between the situation where (a) the utility, realizing that it will incur an extraordinary *expense*, voluntarily approaches the Commission and requests an order allowing deferral of that expense until a subsequent period when the expense can be amortized, and (b) the situation where the Commission orders the utility to defer *revenue* until a future period. Under Micron's proposal, taken to the extreme, the Commission could set an authorized revenue requirement and then order the utility to defer all of its authorized revenue requirement to a future period. Obviously this is an unrealistic scenario but it is not

logically inconsistent. Idaho Power believes that a mandatory deferral of authorized revenues is a violation of Idaho Code § 61-502 as discussed in the *Agricultural Products* case, *supra*, and falls squarely within the prohibition on confiscation of shareholder property described in *Bluefield Waterworks & Improvement Co. v. Pub. Service Com'n of West Virginia*, 260 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923). In *Bluefield* the United States Supreme Court said:

The question in the case is whether the rate prescribed in the Commission's order are confiscatory and therefore beyond legislative power. Rates which are not sufficient to yield a reasonable return on their value in the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment. This is so well settled by numerous decisions of this Court that citations of the cases is scarcely necessary: . . .

One other aspect of Micron's proposal that is of concern to Idaho Power is the impact it would have on the irrigation class. Micron's proposal glosses over the substantial amount of interest that would be charged to the irrigation class if Micron's proposal is adopted. Exhibits 709 and 710 that accompanied Micron witness Peseau's rebuttal testimony show hypothetical five-year and ten-year recoveries of the deferred irrigation rate subsidy. Exhibits 709 and 710 show that, under Micron's five-year recovery program, irrigators would pay total carrying charges in excess of \$8 million. In the ten-year proposal, the carrying charge would exceed \$30 million.

Looking at the ten-year recovery scenario described in Exhibit 710, undoubtedly Idaho Power will be required to come back to the Commission for additional rate relief during that period. In that event, irrigators could be paying rates to (1) recover the revenue requirement set at the beginning of the ten-year deferral period,

(2) an additional amount to recover the deferred costs and including the \$30 million in carrying costs and (3) potential future increases in their rates from future rate cases. If the testimony of the irrigators in this case that any increases in electric rates will drive some irrigators out of business is correct, adoption of the Micron proposal could present something of a “death spiral” for the irrigation class. As rates increase, there are fewer irrigators left to pay the increasing prices needed to cover both the Company’s ongoing revenue requirement and the substantial carrying charge component contained in the amortization of the deferred amount.

To its credit, Micron emphasizes in its testimony that if its proposal is adopted, Idaho Power should be held harmless and not be required to shoulder any of the costs if Micron’s deferral proposal does not turn out as expected. Nevertheless, if the scenario plays out as Idaho Power is concerned that it might, the Company is not so naïve as to believe that transferring costs to other customers that cannot be recovered from irrigators in the future will be viewed with anything other than hostility by the other customer classes.

Micron’s proposal is also unreasonable because of its rigidity. Micron’s proposal assumes the Commission can set rates based solely on cost of service. In fact, the Commission is legally obligated to consider other factors when setting rates. In *Idaho Underground Water Users Ass’n v. Idaho Power Company*, 89 Idaho 147, 404 P.2d 859 (1965), the Idaho Supreme Court acknowledged that the Commission is obligated to consider a number of factors in setting rates. The Court in that case stated:

Concerning assignment of error VIII wherein it is asserted the Commission failed to consider the value of the services to

particular classes of customers, the specific economic conditions affecting members of the appellant association, or the economy of the State of Idaho, we deem this assignment to be without merit. The Commission had before it voluminous testimony concerning the economic conditions of the farming community, the future demands for power for pumping, and many other factors. Certainly we do not minimize the problems created by the “economic squeeze” of increased costs with lowering prices, as testified to by members of appellant; but the record discloses these factors were fully considered by the Commission, and thus are not reviewable by this court, except to determine whether there was evidence to sustain the determination made. *Idaho Underground Water Users Ass’n*, 89 Idaho 147, 167.

Adoption of Micron’s regulatory asset proposal, without consideration of the factors enumerated by the Court in the *Idaho Underground Water Users Ass’n* case, *supra*, would clearly make the Commission’s decision vulnerable on appeal.

Finally, it’s important for the Commission to keep in mind that a deferred asset doesn’t generate cash. Idaho Power cannot use a deferred asset to pay its bills or its dividends. As Mr. Gribble noted in his testimony, financial rating agencies and the financial community as a whole considers at the quality of the Company’s earnings in making their ultimate evaluations of the Company’s value and creditworthiness. Tr. at 2762.

3. Summary. While Idaho Power is certainly sympathetic to the concerns expressed by the other customer classes regarding irrigation rates, Idaho Power does not believe that the proposal presented by Micron is either fair or workable. The inescapable fact remains that cost-of-service is not a static, precise science. It changes over time and it is necessary for the Commission to exercise its judgment to set a revenue requirement and establish rates in which cost of service is one of several considerations. Idaho Power’s prior ability to avoid a general rate case for ten years

was clearly viewed as a benefit by most customers. Unfortunately, it is not likely that Idaho Power will be able to defer general rate cases in the future. Knowing that the Bennett Mountain Plant is under construction, that the Company's capital budgets are dramatically increasing in the next several years in all areas and that the Hells Canyon relicensing is scheduled for completion in 2008, Idaho Power believes that the Commission will have several opportunities to look at the cost of serving the irrigation class prior to the end of this decade. Micron's proposal to create a regulatory asset is both unnecessary and has the potential of creating serious adverse effects for both irrigators, the Company and the Commission.

### **CONCLUSION**

While there were numerous issues raised in this case which the Company could have addressed in its brief, Idaho Power believes that the four items selected all constitute material matters that are significantly affected by legal precedent. The fact that the Company has not addressed other issues in this brief should not be construed as the Company's concurrence with positions taken or recommendations made by Staff or intervenors.

Idaho Power originally filed this case seeking a 17.6 percent rate increase. It has reduced its rate increase request from 17.6 percent to approximately 14.6 percent. Considering that this requested increase covers a ten-year period, the requested 14.6 percent rate increase is less than the cumulative inflation rate over the same period. When you further consider that since the last rate case, the Company has invested nearly \$900 million in additional plant to serve customer requirements, the

requested 14.6 percent rate increase should certainly be considered fair, just and reasonable.

DATED at Boise, Idaho, this 26th day of April, 2004.

A handwritten signature in black ink, appearing to read 'B L Kline', written over a horizontal line.

BARTON L. KLINE  
Attorney for Idaho Power Company

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 26th day of April, 2004, I served a true and correct copy of the within and foregoing IDAHO POWER COMPANY POST-HEARING BRIEF upon the following named parties by the method indicated below, and addressed to the following:

Lisa D. Nordstrom  
Weldon B. Stutzman  
Deputy Attorneys General  
Idaho Public Utilities Commission  
472 W. Washington Street  
P.O. Box 83720  
Boise, Idaho 83720-0074

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (208) 334-3762

Randall C. Budge  
Eric L. Olsen  
Racine, Olson, Nye, Budge & Bailey  
P.O. Box 1391; 201 E. Center  
Pocatello, ID 83204-1391

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (208) 232-6109

Anthony Yankel  
29814 Lake Road  
Bay Village, OH 44140

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (440) 808-1450

Peter J. Richardson  
Richardson & O'Leary  
99 East State Street, Suite 200  
P.O. Box 1849  
Eagle, ID 83616

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (208) 938-7904

Don Reading  
Ben Johnson Associates  
6070 Hill Road  
Boise, ID 83703

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (208) 384-1511

Lawrence A. Gollomp  
Assistant General Counsel  
U. S. Department of Energy  
1000 Independence Avenue, SW  
Washington, D.C. 20585

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (202) 586-7479

Dennis Goins  
Potomac Management Group  
5801 Westchester Street  
Alexandria, VA 22310-1149

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX

Conley E. Ward  
Givens, Pursley LLP  
601 W. Bannock Street  
P.O. Box 2720  
Boise, ID 83701-2720

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (208) 388-1300

Dennis E. Peseau, Ph.D.  
Utility Resources, Inc.  
1500 Liberty Street S.E., Suite 250  
Salem, OR 97302

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (503) 370-9566

Dean J. Miller  
McDevitt & Miller LLP  
P.O. Box 2564  
Boise, ID 83701

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (208) 336-6912

Jeremiah Healy  
United Water Idaho, Inc.  
P.O. Box 190420  
Boise, ID 83719-0420

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (208) 362-7069

William M. Eddie  
Advocates for the West  
P.O. Box 1612  
Boise, ID 83701

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (208) 342-8286

Nancy Hirsh  
NW Energy Coalition  
219 First Ave. South, Suite 100  
Seattle, WA 98104

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (206) 621-0097

Brad M. Purdy  
Attorney at Law  
2019 N. 17th Street  
Boise, ID 83702

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (208) 384-8511

Michael Karp  
147 Appaloosa Lane  
Bellingham, WA 98229

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (360) 724-5272

Michael L. Kurtz, Esq.  
Kurt J. Boehm, Esq.  
Boehm, Kurtz & Lowry  
36 East Seventh Street, Suite 2110  
Cincinnati, OH 45202

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX (513) 421-2764

Kevin Higgins  
39 Market Street, Suite 200  
Salt Lake City, UT 84101

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX

Thomas M. Power  
Economics Department, LA 407  
University of Montana  
32 Campus Drive  
Missoula, MT 59812

Hand Delivered  
 U.S. Mail  
 Overnight Mail  
 FAX



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BARTON L. KLINE