Office of the Secretary
Service Date
September 28, 2004

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR AUTHORITY TO INCREASE ITS INTERIM AND BASE RATES AND CHARGES FOR ELECTRIC SERVICE.	**CASE NO. IPC-E-03-13** **ORDER NO. 29601**

In Idaho Power's general rate case Order issued May 25, 2004, the Commission ordered the Company to calculate its income tax expense using a five-year average. Order No. 29505. When Idaho Power sought reconsideration, the Commission granted the Company's petition as it related to the calculation of the income tax expense for revenue requirement purposes.[1] Order No. 29547. In anticipation of the technical hearing on reconsideration scheduled for September 10, 2004, Idaho Power and Commission Staff ("the Parties") entered in to settlement discussions that resulted in a Stipulation executed and filed August 16, 2004. The Parties also filed a Joint Motion requesting that the Commission accept the Settlement of the income tax expense issue.

On August 18, 2004, the Commission issued a Notice of Proposed Settlement and sought comments from the public and other parties to the rate case regarding the settlement proposed by Idaho Power and Staff. Order No. 29567. After reviewing the record, public comment and the provisions of the Settlement Stipulation, the Commission accepts the Stipulation as a fair, just and reasonable resolution to the income tax expense calculation issue remaining in this case.

THE PROPOSED SETTLEMENT

Idaho Power and Staff filed a Joint Motion for Acceptance of Settlement accompanied by a Stipulation on August 16, 2004. The Parties agreed that Order No. 29505 should be modified to utilize statutory income tax rates to compute test year income tax expense. Applying the statutory rates results in a federal tax rate of 35% (net of state benefit, 32.795%) and a state composite tax rate of 6.3%. On a normalized basis, this change would increase Idaho Power's Idaho jurisdictional test year revenue requirement by $11,504,677.

[1] The Commission also corrected a calculation error and denied reconsideration of the other issues.

The Stipulation provides that, for the period June 1, 2004 through May 31, 2005, the Company will compute and record monthly in a regulatory asset account an amount equal to the additional revenue the Company would have received through its energy rates if its revenue requirement had been determined using the statutory income tax rates rather than the five-year historic average income tax rates. The energy rate to be used to compute the additional monthly revenue to be recorded in the regulatory asset account will be determined in accordance with the formula:

$$\frac{a}{b} = c$$

Where:

a = $11,504,677[2] (normalized increased revenue)

b = 12,476,747 MWh (normalized Idaho jurisdictional energy sales adjusted for load growth of 3.14% per year)

c = $0.92209/MWh

The monthly entry in the regulatory asset account will be computed by multiplying actual MWh sales during the month by $0.92209/MWh. The total amount recovered will include interest on the regulatory asset from June 1, 2004 at the PCA carrying charge rate, which is currently one percent (1%). Exhibit 1 to the Settlement Stipulation shows how the regulatory asset will be accrued assuming normalized Idaho jurisdictional sales levels would occur. To effectuate the deferral, the Parties propose a series of accounting entries that are detailed in the Stipulation.

In addition to the recovery of the income tax expense for the June 1, 2004 through May 31, 2005 period described above, the Company will include $11,504,677 in its base rates after June 1, 2005. However, the Company will not seek to recover in its revenue requirement any deficiency assessed by the Internal Revenue Service related to the one-time adjustment associated with the capitalized overhead cost tax method change for the years 1987 through 2000.

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[2] The Settlement Stipulation refers to both $11,504,667 and $11,504,677 as the normalized increased revenue. While only a difference of $10, the Parties agree that the correct amount is $11,504,677. The Commission's recitation of the Stipulation corrects this typographical error found in the original document. This correction has no effect on the resulting energy rate.

The Parties recommend that the Commission accept the Stipulation without material change or condition. Moreover, the Parties assert that the Stipulation is in the public interest and that all terms of the Stipulation are fair, just and reasonable. The Parties specifically support adoption of the Stipulation and acceptance of the Stipulation by the Commission with the intention that settlement will allow Idaho Power to continue its compliance with the normalization provisions of the Internal Revenue Code and associated Treasury Regulations, and will allow Idaho Power to continue to obtain the benefits of accelerated depreciation.

PUBLIC AND PARTY COMMENTS

In response to its request for comments from the public and parties to the rate case, the Commission received comments from three ratepayers, Idaho Power, and the Commission Staff. Idaho Power customers from Chubbuck and Meridian wrote that "people cannot afford another increase when the economy is still bad" and wondered "how Idaho Power and the other utilities think we can keep paying these higher fees." A third customer from Caldwell described Idaho Power as "very greedy" for wanting to reimburse ratepayers only $19 million of the $40 million refunded by the IRS. He asked the PUC to "say no more [price gouging] and deny any more price increases of any kind for three years" in addition to reimbursing the money Idaho Power has gouged from customers over the next year.

Idaho Power

Idaho Power asserted that the use of the historic five-year average income tax rate would cause the Company to violate the normalization provisions of the Internal Revenue Code and associated Treasury Regulations, and jeopardize Idaho Power's ability to continue to obtain the benefits of accelerated depreciation. If the Internal Revenue Service were to find that Idaho Power violated the normalization requirements and Idaho Power cannot continue to claim the right to use accelerated depreciation , the annual revenue requirement would increase by millions of dollars.

Idaho Power stated that it contacted counsel for all of the parties that participated in this case. All of the parties have authorized Idaho Power to represent to the Commission that they do not object to the Commission's acceptance of the proposed settlement. Idaho Power believes that the lack of opposition to the settlement embodied in the Stipulation supports the conclusion that the overall settlement is fair, just and reasonable and in the public interest.

Consequently, Idaho Power urges the Commission to issue its Order granting the Joint Motion and approving the Settlement Stipulation.

Commission Staff

While the Staff does not necessarily agree that the Company would lose the ability to use accelerated depreciation for income tax purposes, the proposed modifications to the Commission's decision will ensure continued compliance with the normalization provisions of the Internal Revenue Code and associated Treasury Regulations such that an IRS disallowance of accelerated depreciation benefits will not be triggered. This provides a substantial benefit to customers currently and in the future. If the accelerated depreciation was lost, income taxes would be significantly higher and Idaho Power would be required to obtain additional financing and probably increase rates further to cover the tax expense.

Ratepayers will also benefit from the Company's guarantee in the Stipulation that it will not seek recovery of any additional IRS income tax deficiency assessments for the one-time capitalized overhead cost tax method change for the years 1987 - 2000. Moreover, rehearing of this issue and possible appeal to the Idaho Supreme Court would have taken a significant amount of time and resources of the Commission and its Staff. If Idaho Power requested a Private Letter Ruling from the IRS, it would require additional time to obtain the ruling without any assurance that customers would receive any benefit from this protracted process.

The settlement, with the ongoing tax expense allowance no longer being an issue, will also allow Idaho Power and the Commission's regulatory actions to be viewed positively by the various rating agencies. Base rates will reflect the statutory income tax rate, the risk of recovery is reduced, and borrowing costs may be less expensive. For these reasons, Staff argued that the Stipulation is in the best interest of all parties.

COMMISSION FINDINGS AND DISCUSSION

Pursuant to Commission Rule 274 we shall decide whether to accept the Stipulation and Settlement Agreement based on the record currently before us. IDAPA 31.01.01.274. The record is substantial and all parties that materially participated in this docket have either signed this Agreement or did not actively oppose it. Accordingly, we find further proceedings are not necessary for us to determine whether we should accept this Agreement.

As set out in the record, Idaho Power sought approval to use the effective rates of 32.795% for federal and 5.9% for Idaho state income taxes. In Order No. 29505, we approved

use of the five-year average tax rates of 25.24% federal and 5.62% state to account for higher future taxes that will result from a one-time federal tax benefit allowing it to allocate indirect overhead costs to inventory and expense them in the current period. The new tax method decreased Idaho Power's taxable income when applied to the mixed service costs incurred by the Company. The Company elected to use this new methodology, enabling it to collect a $41 million refund in 2002 on taxes paid in prior years and push income tax expense to future dates. As a result, ratepayers will have to pay higher taxes in the future when the timing differences reverse to pay back the U.S. Treasury for the refund (i.e., loan) given to Idaho Power.

Idaho Power strongly objected to the Commission's use of the historic five-year average tax rates. In its Petition for Reconsideration, Idaho Power argued that use of the proxy tax rate violates principles against retroactive ratemaking. Moreover, serious consequences to the Company "would ensue if the Commission's Order violates the normalization requirements of the Internal Revenue Code." Petition for Reconsideration p. 11. In light of the concern raised by these arguments and at the request of Staff and the Company, we determined that reconsideration was appropriate for the purpose of receiving additional evidence on the tax expense issue.

Although we originally approved use of the five-year average, we are concerned about the uncertainty created by the resulting IRS challenge and the risks that litigation on this matter might pose to ratepayers. This Settlement ensures that ratepayers will continue to benefit from accumulated depreciation and pay no tax deficiency assessments for the one-time capitalized overhead tax method change for the years 1987-2000. Avoiding the protracted litigation that would accompany this case absent acceptance of the Settlement Stipulation will likely lower the cost ratepayers will ultimately pay for Idaho Power to borrow money to finance ongoing operations. For these reasons, the Commission adopts and approves the Stipulation as presented.

We find that this Stipulation finally resolves the remaining income tax expense issue among the parties. We further find that this Stipulation has been made to compromise contested claims and is entered largely for the purpose of avoiding expense, inconvenience, and uncertainty of further litigation. Pursuant to Commission Rule 275 we find that the parties have carried their burden of showing that the Stipulation is just, fair and reasonable, in the public interest, and in accordance with the law and regulatory policy of this State. IDAPA

31.01.01.275. Accordingly, we accept the Stipulation as proposed by the parties without modification.

ORDER

IT IS HEREBY ORDERED that the proposed Stipulation is just, fair and reasonable, in the public interest, and in accordance with the law and regulatory policy of this State. Accordingly, we accept the Stipulation as proposed by the parties in settlement of the income tax expense issue in this docket. Thus, the Joint Motion for Acceptance of Settlement is granted.

IT IS FURTHER ORDERED that the parties shall comply with all terms contained in the Stipulation.

THIS IS A FINAL ORDER ON RECONSIDERATION. Any party aggrieved by this Order or other final or interlocutory Orders previously issued in this Case No. IPC-E-03-13 may appeal to the Supreme Court of Idaho pursuant to the Public Utilities Law and the Idaho Appellate Rules. See *Idaho Code* § 61-627.

DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho, this 28th day of September 2004.

PAUL KJELLANDER, PRESIDENT

MARSHA H. SMITH, COMMISSIONER

DENNIS S. HANSEN, COMMISSIONER

ATTEST:

Jean D. Jewell
Commission Secretary

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