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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**

DIRECT TESTIMONY OF ALDEN HOLM

IDAHO PUBLIC UTILITIES COMMISSION

FEBRUARY 20, 2004

Q. Please state your name and business address for the record.

A. My name is Alden Holm. My business address is 472 West Washington Street, Boise, Idaho.

Q. By whom are you employed and in what capacity?

A. I am employed by the Idaho Public Utilities Commission (Commission) as a senior auditor in the accounting section.

Q. What is your educational and professional background?

A. I graduated from Boise State University in 1994 with a B.B.A. degree in Accounting. In 1998, I completed a Masters Degree in Public Administration from Boise State University. Prior to joining the Commission Staff in 2000, I worked for two years as an accountant at the Boise Metro Chamber of Commerce and two years as an accountant at Rocky Mountain Audio Visual, Inc. I have attended the annual regulatory studies program sponsored by the National Association of Regulatory Utilities Commissioners (NARUC) at Michigan State University. I am also a member of the Finance and Accounting Subcommittee of NARUC. I am a Certified Public Accountant licensed in the state of Idaho.

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

A. I am responsible for overseeing the Commission Staff’s (Staff) audit of Idaho Power Company (Idaho Power) and the 2003 test year. I will present many of Staff’s revenue requirement adjustments and I have prepared Staff’s summary revenue requirement exhibits. I am Staff’s main revenue requirement witness so I will address any revenue requirement issues not addressed elsewhere.

My testimony outlines Staff’s proposed adjustments to Idaho Power’s revenue requirement as filed in this case. The adjustments can be broken into four main categories – a review of Idaho Power’s proposed test year and additions to that test year, salaries and incentive pay, income taxes, and other adjustments. I will discuss each of these items individually.

Q. What exhibits are you sponsoring?

A. I am sponsoring Staff Exhibit Nos. 101 through 107. These exhibits outline Staff’s proposed revenue requirement and adjustments to Idaho Power’s proposed test year.

Q. Will you please review Staff Exhibit No. 101?

A. Certainly. This exhibit highlights Staff’s revenue requirement calculations. The first page is the Table of Contents for Staff Exhibit No. 101, identifying each schedule in the exhibit. Schedule 1 shows the overall revenue requirement for Idaho. Staff witness

Keith Hessing will address the jurisdictional separation study.

The total Idaho revenue requirement proposed by Staff is $498,758,249. This requires an overall base rate increase of $14,796,880 or 3.06%. Due to the timing of this case, some of the adjustments were finalized after the cost of service, allocation to classes and rate design studies were essentially complete. Therefore, a revenue requirement of $499,161,903 resulting in a revenue increase of $15,200,534 and a 3.14% average increase in rates was utilized for these studies. The differences do not change the policy positions taken by Staff witnesses Hessing and Schunke. Staff recommends these changes be incorporated, if accepted, by the Commission in its final order in this case.

Q. Did you prepare an exhibit that shows how your calculation of the revenue requirement was made?

A. Yes. Staff Exhibit No. 101 shows how the system revenue requirement was calculated. Schedule 1 of the exhibit shows the calculation of the overall system and Idaho revenue requirements using Idaho Power's proposed test year, Staff adjustments, Staff's proposed rate of return, and Staff's recommended distribution of costs and revenues between Idaho and the other jurisdictions. The rest of the schedules in Staff Exhibit No. 101 provide the details supporting Schedule 1. Those schedules show the total amount per Idaho Power's books using the actual and forecasted test year as filed in Column A, any Idaho Power normalizing adjustments in Column B, Idaho Power's annualizing adjustments in Column C, Idaho Power's known and measurable adjustments in Column D, other adjustments in Columns E, and Staff's proposed adjustments in Column F. The totals in Column G transfer over to the appropriate place in Schedule 1.

PROPOSED TEST YEAR AND IDAHO POWER ADDITIONS TO THE TEST YEAR

Q. Please explain how Idaho Power presented its 2003 test year.

A. Idaho Power has proposed a test year based on six months of actual expenses and revenues (January 2003 through June 2003) and six months of forecasted or budgeted revenues and expenses (July 2003 through December 2003). Idaho Power states that this test year is appropriate because it provides the most current information and allows Idaho Power time to better split out transactions between companies affiliated with IDACORP, Inc. (IDACORP). However, the 2003 test year chosen by Idaho Power limits customer sharing of a substantial benefit Idaho Power received during 2002 due to a significant income tax adjustment (discussed in

LaMont Keen's direct testimony, page 26, lines 1-5). Use of the 2003 forecast months also limits the ability of Staff and the other parties to review actual amounts during the fourth quarter, specifically December and year-end adjustments, before filing testimony in this case.

Q. Did the parties to this case discuss the test year and its complications?

A. Yes. At the prehearing conference, Idaho Power represented that it would allow the Commission Staff to review the actual data and present updated information on a supplemental basis if necessary before the Commission made its final decision. Staff will continue to review data and recommend changes as necessary.

Q. Please explain Staff's changes to Idaho Power's proposed test year.

A. As part of our proposed revenue requirement Staff has adjusted Idaho Power's test year to reflect actual non-operating revenues, expenses and rate base amounts through November 2003 with a forecast for December 2003. This change represents a benefit to customers of about $6.5 million because even though the rate base accounts increased slightly, the actual expenses were significantly less than the forecasted amounts and the other revenues were significantly higher.

Staff did not receive actual account totals for

December 2003 in time to fully audit and incorporate the actual figures in our testimony and exhibits. Because Idaho Power's forecast through November 2003 was overstated by about $1.3 million per month, Staff has adjusted the December 2003 revenue and expense forecast by the average amount each account was over- or understated in previous monthly forecasts. This forecast adjustment results in a revenue requirement decrease of an additional $1.3 million. Staff will review the impact of the December actual financial amounts as this case continues.

IDAHO POWER'S PROPOSED TEST YEAR ADJUSTMENTS

Q. Based on your review of Idaho Power's proposed test year adjustments, what does Staff recommend regarding each proposed adjustment?

A. The Commission Staff has placed Idaho Power's proposed adjustments into three categories. First, there are some adjustments Staff accepts as reasonable. Second, there are adjustments proposed by Idaho Power that have merit, but for a variety of reasons require a modification. Finally, there are proposed adjustments that Staff does not accept. I will discuss each adjustment category and each adjustment individually.

Idaho Power-Proposed Adjustments That Should Be Adopted

Q. Which Idaho Power adjustments does Staff recommend the Commission adopt?

A. Staff recommends the Commission adopt the following six Idaho Power adjustments:

1. The first Company adjustment relates to general advertising expense in Account 930.1. This account contains expenses relating to advertising and image enhancement including, the advertisements promoting Idaho Power's need for a rate increase that aired last year. Idaho Power has removed all the 930.1 expenses from the rate case so that customers will pay for none of these items. Staff supports this reduction of $452,109 as reasonable and necessary.

2. Idaho Power makes an adjustment for a 2002 prescription drug expense that was booked during 2003. This amount was appropriately removed after Idaho Power was billed late and posted the amount during 2003. Staff accepts the adjustment of $280,107 to reduce 2003 test year expenses.

3. Idaho Power makes an adjustment of $728,766 to Account 182 for the incremental security costs that it deferred as a result of Order No. 28975, Case No. IPC-E-01-41. Staff witness Leckie testifies to these costs in greater detail.

4. There are items relating to the Prairie Power Acquisition Adjustment that continue to be amortized. Idaho Power proposes to reduce rate base by

$422,264 for this adjustment. Staff witness Leckie will further discuss this issue in his testimony.

5. Staff accepts the adjustment relating to the additional Cable One revenue of $346,171. Idaho Power has added the amount to the test year to replace a billing that was missed during the year 2003.

6. Staff witness Leckie will discuss the Asset Retirement Obligation adjustment proposed by Idaho Power. This adjustment requires $106 million be added to accumulated depreciation and $1.58 million be removed from rate base to reverse the effects of Idaho Power's implementation of Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset Retirement Obligations. Idaho Power is required to implement SFAS 143 in order to comply with Generally Accepted Accounting Principles but not for ratemaking purposes. Therefore, this adjustment appropriately reverses the effect of the SFAS 143 implementation as discussed by Mr. Leckie.

Idaho Power Proposed Adjustments That Should Be Changed

Q. Which Idaho Power adjustments have merit but should be attributed a different dollar amount than that proposed by Idaho Power?

A. The following seven Company adjustments need to be revised. These adjustments are summarized on Staff Exhibit No. 102, Schedule 1:

1. The first adjustment relates to an increase in operating payroll for known and measurable changes. Idaho Power proposes to increase the payroll expense $2,913,244 by using the projected December 2003 payroll to forecast the salary expense through 2004. Staff supports this adjustment if the actual December 2003 payroll amount is used instead of the projection. By using the actual December amount, Staff reduces the adjustment to $860,590. This is discussed in greater detail later in my testimony on page 24. See line 1 of Staff Exhibit No. 102, Schedule 1. Schedule 2 of Staff Exhibit No. 102 provides additional details.

2. Idaho Power also proposes to increase its operating expense by $2,241,595 for forecasted general salary increases during 2004. Once again, the original adjustment was based on the forecasted payroll amount. Staff would support this adjustment if it were based on the actual December payroll instead of the forecasted December payroll. Staff proposes to reduce the adjustment to $2,124,920. This is also discussed later in my testimony under the Salaries and Incentive Pay section on page 25. See Staff Exhibit No. 102, Schedule 1, line 2 and Schedule 3 for calculation details.

3. During 2003, Idaho Power filed Case No. IPC-E-03-7 to change its depreciation rates for its plant.

Idaho Power filed this rate case based on the depreciation rates that it requested in that case. Staff and the other parties in the Case No. IPC-E-03-7 have subsequently reached a stipulation that was approved by the Commission in Order No. 29313. Staff recommends accepting the depreciation expense change, but proposes that the change be based on the stipulated rates approved by the Commission. This change will result in a decrease to accumulated depreciation of $2,205,647 and a decrease to depreciation expense of $4,411,294 from Idaho Power's original filing. See Staff Exhibit No. 102, Schedule 1, lines 3-4, and Schedule 4, for calculation details.

4. Idaho Power requests recovery of $4,953 for intervenor funding payments made to the Land and Water Fund of the Rockies related to Case No. IPC-E-01-13 on Demand Side Management. In addition, Idaho Power requests recovery of another $5,335 it paid to the Idaho Irrigation Pumpers Association during 2003 in the Power Cost Adjustment, Case No. IPC-E-03-5. It is not reasonable for Idaho Power to be allowed recovery of these entire amounts in the test year as if they occur each and every year until the next rate case. Instead, Staff proposes recovery of a yearly amortization of $2,017 over five years to avoid over-recovery. I will discuss this adjustment in greater detail later in my testimony on

pages 35 and 36. See Staff Exhibit No. 102, Schedule 1, line 5.

5. The next Idaho Power adjustment removes some memberships and contributions Idaho Power has determined to be unreasonable based on past Commission decisions. These memberships include the Idaho Mining Association, the Idaho Water Users Association and the Wyoming Taxpayers Association. The contributions removed were for Kenneth Berain and a company called Global Insight in the amount of $28,384. Staff supports this adjustment and recommends that additional contributions in the amount of $322,177 also be removed. Staff witness English will discuss the additional items Staff is recommending for removal. See Staff Exhibit No. 102, Schedule 1, line 6.

6. Idaho Power's American Falls bond interest adjustment increases the variable interest rate amount to be included in rates based its forecast of increased interest rates. Given actual interest rate trends, Staff recommends the amount be reduced by $29,419 instead of increased by $297,436 as requested by Idaho Power. Staff witness English discusses this adjustment in his testimony. See line 7 of Staff Exhibit No. 102, Schedule 1.

7. Staff witness Leckie will discuss Idaho Power's proposed adjustments that relate to the known and

measurable changes to physical plant of approximately $18.4 million. Staff recommends a different methodology to calculate the known and measurable plant adjustment that results in an addition to rate base of approximately $1.4 million instead of the proposed $18.4 million. See line 8 of Staff Exhibit No. 102, Schedule 1.

Idaho Power-Proposed Adjustments That Should Not Be Approved

Q. Finally, which Idaho Power adjustments does Staff recommend the Commission deny outright?

A. Staff recommends the Commission deny the following five proposed adjustments. These adjustments are shown on Staff Exhibit No. 103.

1. Idaho Power makes an adjustment for property and liability insurance as a known and measurable change during the year 2004. Staff does not support this adjustment because the amount of the increase is not known and measurable; it is simply an estimate of the new policy costs that may go into effect sometime during 2004. In addition to a price change, Idaho Power states that the coverage amounts may also change – some coverage amounts may increase while others may decrease. The costs of the policies are not known at this time; they are simply estimated. Therefore, Staff removes the $364,014 of increased insurance costs from Idaho Power's requested

revenue requirement. See line 1 of Staff Exhibit No. 103.

2. The next adjustment is based on the same projected 2004 increases in liability and property insurance mentioned above. Because the policies will expire during 2004 and may be renewed at a higher rate, Idaho Power suggests that the estimated amount should be annualized and included in the test year expenses. Staff does not support this adjustment because the amount of the increase is not known and measurable and is simply an estimate of the new policies that will go into effect sometime during 2004. Therefore, these forecasted increased costs should be excluded. See Staff Exhibit No. 103, line 2.

3. The next adjustment proposed by Idaho Power increases the amount of incentive pay from zero to $5,114,821. After December 2003, Idaho Power updated its proposed incentive payment amount to $4,837,358 based on the actual year-end payroll amount instead of the forecasted amount. Staff does not support this adjustment because it is inappropriate to establish and charge customers for incentive pay based primarily on the returns earned by shareholders. This incentive pay format can be used to increase shareholder returns at the possible expense of ratepayers. Staff also believes Idaho Power employees are compensated adequately with the base salary

and benefits. I will discuss the salary and incentive pay in detail below. See line 3 of Staff Exhibit No. 103.

4. Idaho Power proposes an operating pension expense increase of $2,170,163 to the test year. Staff does not support this adjustment because we do not believe Idaho Power should collect funds from customers when it does not make contributions to the pension fund. Staff witness English will discuss this adjustment. See line 4 of Staff Exhibit No. 103.

5. Staff witness English will also address the proposed prepaid pension adjustment of $17,800,477 Idaho Power requests to rate base. Staff does not believe Idaho Power should receive a return on this amount when customers and market conditions provided the prepaid expense. See line 5 of Staff Exhibit No. 103.

6. Finally, Staff witness Leckie will discuss Idaho Power's annualizing adjustment. This adjustment increases rate base by $19,779,389 and expenses by $873,129. Staff believes it is not reasonable to collect this from ratepayers because the adjustment is not consistent with the thirteen-month average rate base methodology. See line 6 of Staff Exhibit No. 103.

SALARIES AND INCENTIVE PAY

Q. Did you prepare an exhibit containing information regarding Idaho Power's salary and benefits package?

A. Yes. Staff Exhibit No. 104 contains information relating to the salaries of Idaho Power employees. Page 1 has three charts. The first chart shows the average Idaho Power salary since 1996 and the yearly change. The second chart compares the Idaho Power average salary with the average salaries of classified employees of the State of Idaho for two years. Finally, there is a chart that compares the average employee turnover for Idaho Power versus classified state employees.

The next three pages of the exhibit are salary surveys Staff has obtained to use as a comparison for Idaho Power salaries. The first survey shows the average salary in Boise Idaho to be $46,386. The second survey shows the average salary in Boise to be 85.6% of the national average. Finally, the Department of Labor shows the average cash compensation to employees to be $17.52 per hour or $36,442 per year. While these surveys may not directly tie to Idaho Power's employees' salaries, Staff believes they provide at least some basis for comparison.

Q. Please describe Idaho Power's salary and benefits package for its employees.

A. Idaho Power has a generous salary and benefit package compared to the average Boise salary. According to Idaho Power, the purpose of the higher salary and benefits is to attract and retain highly qualified employees. Idaho Power has been very successful at employee retention. For example, employee turnover was a mere 2.3% during 2003. By comparison, the State of Idaho, traditionally known as a stable employer with excellent benefits, has had turnover rates in the range of 12% to 18% over the last few years.

Idaho Power sets base salaries on the 50th percentile of various salary surveys. The majority of the surveys are national. That means that the salaries are mostly based on a national level even though Idaho has traditionally been a lower-income state. In addition to an excellent salary, Idaho Power pays most of the health insurance benefits for employees. Idaho Power provides typical paid time off for vacations, sickness and holidays. It also offers service awards, education and training benefits, life and disability insurance programs, an employee assistance plan and a pension plan fully funded by Idaho Power without any contribution from employees. Idaho Power also offers an additional 401(k) retirement plan that matches up to 4% of a participating employee's salary. Staff witness English will describe these two retirement plans in more detail.

During 2003, the average base salary of Idaho Power's employees was $59,173. That compares well to the average salary of $46,386 for a full-time worker in Boise (http://www.payscale.com/salary-survey/aid-42652/fid-79/fid-6886/RANAME-SALARY, Real-time salary survey for Boise, ID. January 28, 2004 shown as Staff Exhibit No. 104, page 2 of 4) and the average salary of $33,891 for a classified state of Idaho employee. *Change in Employment Compensation Supplement*, Idaho Division of Human Resources, October 1, 2003, page 3. The Idaho Power base salary does not include any additional amounts paid as incentive pay to employees. Staff has reviewed additional salary surveys showing that the average salary for all workers in the United States is $36,442 (Staff Exhibit No. 104, page 4 of 4) and that the average salary in Boise, Idaho is 85.6% of the national average (Staff Exhibit No. 104, page 3 of 4).

Q. Did you review salaries and benefits for Idaho Power's executives?

A. Yes. Idaho Power uses a consultant to prepare a survey of the cash and benefits that similarly sized regulated and non-regulated utility companies paid to their executives. Idaho Power Company pays its executives a base salary comparable to a 50th percentile of the comparable companies. Staff believes it is reasonable to pay executives on a national scale because they are often recruited nationally, even though Idaho Power has promoted most executives internally. In addition, executives that work for other IDACORP entities have at least a portion of their salary and benefit costs allocated to the appropriate IDACORP entity. This shifts some of the costs away from ratepayers.

Some executives also have additional compensation benefits that relate to IDACORP performance goals. Other than the incentive plan discussed below, these additional benefits are appropriately paid by IDACORP or from shareholder funds, not by ratepayers. Staff believes that IDACORP shareholders should pay for all incentives that are based on IDACORP goals.

Q. Is Staff proposing any adjustments to these salary or benefit items that Idaho Power pays its employees or executives?

A. No. While the base salary and benefits are very generous, they should not be adjusted unless the Commission decides to allow the incentive payments as a ratepayer expense. If Idaho Power customers pay for the incentive payments, the total cash compensation to be included in rates should be reduced to the 50^{th} percentile instead of the 60^{th} percentile (essentially reducing base pay instead of eliminating the incentive pay). A fair overall compensation package does not require both 50^{th} percentile salary and a seven percent incentive payment to be paid for by ratepayers, especially when the 50th percentile is based mostly on national salary levels.

Idaho Power's Incentive Payments Plan

Q. Please describe the exhibit you prepared regarding Idaho Power's Incentive Plan (the Plan).

A. Certainly. Staff Exhibit No. 105 contains information regarding the Plan. Page 1 shows the Salary Structure Adjustments all employees have received since 1995 and the average amounts paid out each year as incentive payments. Page 2 is a memorandum responding to an audit request and is quoted later in my testimony. Pages 3-5 contain a letter that went out to all employees explaining the new incentive plan and the amount of the Salary Structure adjustment for 1995. Finally, pages 6-17 are taken directly from Idaho Power's Employee Handbook and explain in greater detail how the Plan works and how employees will be rewarded under the Plan.

Q. Please describe Idaho Power's 2003 Employee Incentive Plan and its requested recovery amounts.

A. The Plan was designed to incentivize employees to think like IDACORP owners and to provide additional compensation when IDACORP earnings goals are exceeded. All designated employees of IDACORP, Inc. and its subsidiaries, except IDACORP Energy, are eligible to participate in the Plan. The Plan is designed to reward

Idaho Power employees with additional compensation when IDACORP's earnings per share reach a desired amount. To accomplish the Plan's goals, the Plan pays employees an additional percentage of their base salary when IDACORP's earnings per share reach certain levels. In other words, as IDACORP's earnings per share increases, the incentive pay for employees increases. Most employees are eligible to earn incentive pay from 0% to 15% of their base pay depending on the earnings per share. The percentage range is significantly higher for managers and for executives.

In Idaho Power's Employee Handbook, employees are encouraged to think like shareholders and make decisions that are in the best interest of shareholders. In the section that explains how employees can increase their incentive pay, the Handbook states, "*Earnings on common stock focuses attention on thinking like an owner*." The Incentive Compensation section of the Idaho Power Company Employee Handbook, (emphasis in original) is also included as Staff Exhibit No. 105, pages 6-17.

Q. Can you describe how the incentive pay system was set up and implemented?

A. Certainly. According to the information Staff received from Idaho Power, the incentive payment program was implemented in 1995. To initiate the program, Idaho Power decided to move from paying employees base salaries at the 60th percentile to the 50th percentile and use the difference as incentive pay. In his direct testimony, Mr. Ric Gale states, "After the incentive was added to the compensation package, the benchmark for the base pay was reduced to the 50th percentile". Ric Gale Direct Testimony, page 7, lines 17-19. That implies that employees had their base salaries reduced so they would receive the same amount of money when the incentive payments kicked in. However, when asked for a list of employees that had their base pay reduced when the Plan began, Idaho Power replied that there were none. Moreover,

> There was never intent to implement an immediate shift from the 60th to the 50th percentile; as such no employee's pay was reduced. Rather, employees in classifications that were significantly over market had their pay "frozen" (i.e., no pay increases of any type) until the market caught up with actual pay.

IPC response to Staff Audit Request #42, Meredith Obenchain, November 17, 2003. See Staff Exhibit No. 105, page 2, for the entire response.

In other words, when Idaho Power states that pay was placed "at risk," they imply that salaries were reduced. Ric Gale Direct Testimony, page 7, line 5. In reality, there were no reductions to any employee's salary. Instead, Idaho Power states that some employees simply did not get the annual raises they were used to receiving. However, during 1995, the first year of the incentive payments, all employees were given a 2.5% General Wage Adjustment to maintain the competitiveness of Idaho Power's salaries compared to the national salary survey Idaho Power was using at the time. See Staff Exhibit No. 105, page 1. It seems that the majority of employees simply received the incentive pay as additional compensation and lost nothing from the switch to the incentive plan.

The amount of incentive pay has varied from year to year as earnings per share have varied. The level of payment also varies by the employees' level of management responsibility. Regular employees have received between 2.6% and 15% of their base salary as incentive payments. Managers have received between 5.66% and 20%, and officers have received between 0% and 80% of their base salaries as incentive payments. The CEO has received between 0% and 100% of his base salary as incentive payments.

In its Application, Idaho Power asks to recover approximately $5.1 million for employee incentive pay. Idaho Power subsequently updated its forecast of incentive payments to $4,837,358 instead of the original $5,114,821. This amount represents the middle level or the expected target of the possible award and would be approximately 7% of base pay for most employees.

Q. Please explain Staff's recommendation on Idaho Power's incentive payments adjustment.

A. As I mentioned above, Staff does not support the incentive payments adjustment for two reasons. First, Idaho Power compensates its employees adequately without the incentive pay. The base salary and benefits are already generous when compared to local salaries and wages. Second, the group that receives the direct benefits resulting from the incentive payments to employees - the shareholders of IDACORP - should pay for the incentive compensation. Some of Idaho Power's executives receive additional compensation from IDACORP that is not passed on to ratepayers. These incentive payments should be treated like those additional executive incentive plans and paid for by IDACORP shareholders. Ratepayers do not directly benefit when IDACORP's earning goals are achieved or exceeded and thus should not fund this program.

A portion of all incentive payments is capitalized. In order to remove all the effects of the incentive pay, an adjustment of $7,741,747 to the rate base as well as an adjustment of $230,594 to annual depreciation expense are required to completely remove the costs associated with the capitalized incentive payments. In addition to the removal of the capitalized amounts and the associated depreciation expense, the underlying $5,114,821 expense Idaho Power requests for recovery in the 2003 test year should be removed.

Q. You mentioned earlier that Staff had some other adjustments to salary expense. Can you describe those adjustments now?

A. Certainly. As I mentioned above, Idaho Power has proposed to increase its salary expense based on the projected December 2003 amounts. This adjustment takes into consideration all the salary increases employees have received during the year 2003 and annualizes the salary expense to the 2003 year-end level. Idaho Power proposed to increase the amount by $2,913,244. Staff has reviewed the actual December 2003 payroll amount and it is significantly lower than the projected amount. We believe it is reasonable to increase the base salary expense using the actual amount instead of the projected amount. By using the actual payroll expense, the correct increase is calculated to be $860,590 instead of the $2,913,244 originally proposed by Idaho Power. Therefore, Idaho Power's base salary adjustment should be reduced by $2,052,654. See Staff Exhibit No. 102, Schedule 1, line 1, and page 2, for calculation details.

Q. What is the final adjustment to salaries you would like to propose?

A. As I mentioned above, the general salary structure adjustment should be corrected. This adjustment is based on the annual raise all employees receive at the end of the year. The amount has traditionally been about three percent (3%). Once again, the original adjustment was based on a forecasted payroll amount increased by the three percent (3%). This adjustment would be justified if it were based on the actual December payroll instead of the forecasted December payroll. However, because the actual payroll amount of $2,124,920 is less than the projected amount of $2,241,595, the payroll expense increase must be less than originally requested. Therefore, Idaho Power's test year expense should be reduced by $116,675. See Staff Exhibit No. 102, Schedule 1, line 2, and page 3, for calculation details.

INCOME TAXES

Q. Did Staff prepare an exhibit relating to income taxes?

A. Yes. Staff Exhibit No. 106 shows Staff's calculations relating to income taxes. Schedule 1 shows the effective tax rate calculation and the gross-up calculations as proposed by Idaho Power and Staff. Schedule 2, pages 1-2 show the deferred taxes calculations proposed by Idaho Power and Staff. Finally, Schedule 3 shows Staff's calculation of the average additional tax assessments.

Q. Please provide an overview of Idaho Power's income tax philosophies.

A. Idaho Power employs a group of tax professionals who are charged with reducing current income tax amounts. The federal tax regulations are complex and allow a wide variety of deductions that permit companies to push tax expense from current periods into future periods. The acceptable methodologies used to calculate the deductions are not always clear right after the tax laws have been passed. Therefore, companies exercise some discretion to interpret the laws and maximize deductions in the current period. Idaho Power appropriately maximizes these deductions and seeks to utilize all available methods to push income tax expense into the future knowing that the Internal Revenue Service (IRS) will ultimately determine the appropriate deduction calculation methodologies and audit Idaho Power's filings. These audits are conducted regularly and often result in additional tax payments.

In its present Application, Idaho Power requests to recover income taxes at statutory rates adjusted for various items. These items include differences between tax and book amounts, permanent differences and regulatory items. Some of these items are fairly stable, while others can change dramatically between years. The result is an effective tax rate that can vary from year to year.

Staff supports Idaho Power's efforts to reduce its current income tax expense. However, for rate setting purposes, Idaho Power has the opportunity to benefit from significant swings in income tax expense while withholding these benefits from customers when choosing its test year. For example, during 2002, Idaho Power received a tax benefit of more than $31 million dollars and booked a sizeable reserve that could materially benefit Idaho Power and its shareholders later when the 2002 IRS audit is final. See LaMont Keen's Direct Testimony, page 26, lines 1-5. Staff believes rates should be set to better reflect the benefits and risks of income tax expense fluctuations.

Q. Please describe the tax benefit referred to in Mr. Keen's testimony.

A. Certainly. After the terrorist attacks in September 2001 and the subsequent economic impacts, the U.S. Congress and the President passed legislation that allowed certain businesses additional tax benefits. One of these benefits allowed Idaho Power to allocate indirect overhead costs to inventory and expense them in the current period. Idaho Power refiled several returns from prior years using the new methodology. This allowed Idaho Power to collect a refund on taxes paid in prior years and push income tax expense to future dates. As a result of the refiled tax returns, Idaho Power received approximately $41 million cash during 2002 as a tax refund. Of that amount, Idaho Power flowed to earnings about $31 million and created a reserve of $10 million to keep in case of an assessment by the IRS at a later date. If the IRS approves of the manner Idaho Power calculated the revised income taxes, it will not assess additional tax and the $10 million reserve will also be flowed to earnings. Any additional assessment will reduce the reserve.

Idaho Power continues to calculate its income tax expense using the same overhead cost methodology during 2003. This tax benefit of approximately $5 million provides a benefit to customers during 2003 and is included in the test year. The amount will continue to decrease each year, and eventually the income tax that was avoided or refunded will have to be paid back at a later date. Staff is concerned that Idaho Power has taken the large benefit for shareholders and used 2003 as a test year so that it could keep the tax refund for itself while customers pay the higher taxes now and in the future when timing differences reverse.

Q. Please describe Idaho Power's calculation for income tax.

A. In its test year, Idaho Power uses statutory rates to calculate income tax. It then uses the estimated deductions and additions (including the $5 million for overhead costs I mentioned above) for 2003 to reduce or add to income tax expense.

Q. How does Staff propose to calculate the income tax expense?

A. Staff proposes to smooth out the significant swings in income tax expense by using the average effective rate over the last five years including 2003. This allows Idaho Power and its customers to take advantage of the aggressive tax strategies Idaho Power uses. It also reduces Idaho Power's ability to game the test year process to its advantage by keeping the unprecedented 2002 flow-through tax benefits for its shareholders and passing through to customers IRS tax audit payments made in 2003.

Q. If the average effective rate is used, how does it compare to the rate proposed by Idaho Power?

A. Over the last five years, the average effective rate for Idaho Power's above the line income tax expense has varied dramatically. The federal rate has been as high as 37.97% in 2001 and as low as negative 4.16% in 2002, the year of the large tax benefit. Other than 2001, it has been below the statutory rate of 35% that Idaho Power is requesting in this case. Staff proposes using an average rate of 25.24%. This rate smoothes out the significant tax swings in the last five years and provides a more realistic basis for tax expense over time to use in the test year for ratemaking. A three-year average would produce an effective federal tax rate of 22.14%. Although Idaho Power is on a three-year IRS audit cycle, these tax changes and tax rate are not tied to the audit cycle. Staff believes a three-year average weights the lower rate in 2002 too heavily when the tax benefit results from changes in refiling multiple tax years. The different time frames and dollar impact supports using an average over the five-year period rather than the three-year audit period to be more representative over time. See Staff Exhibit No. 106, Schedule 1, for calculation details.

Q. Did you adjust the state income tax rate as well?

A. Yes. The state rate has been as high as 10.29% in 2001 and as low as .23% in 2002. Staff proposes to use the average rate over a five-year period including 2003 of 5.62% as opposed to the 5.9% proposed by Idaho Power. See Staff Exhibit No. 106, Schedule 1, for calculation details.

Q. Does the rate change require a change to deferred taxes as well?

A. Yes. I adjusted the test year's deferred tax changes using the lower averaged rate. This lower rate reduced deferred taxes by $352,405. See Staff Exhibit No. 106, Schedule 2, pages 1-2, for calculation details.

Q. If Staff was so concerned about the large benefit received during 2002, why doesn't Staff propose to amortize it instead of averaging the tax rates?

A. Staff considered an amortization of the tax benefit, but chose the alternative because amortization might have required Idaho Power to restate its financial statements for 2002 and 2003. By using the average effective tax rate, we are looking forward instead of backwards. This allows customers to benefit from the lower effective rate now since they will pay more later as timing differences reverse. Idaho Power should not have to restate any financial statements by using Staff's proposed methodology.

Q. Does changing the income tax rates used in the test year require a change to the gross-up factor as well?

A. Yes. Staff proposes to use the same rate for the gross-up factor as that used to calculate the effective tax rate for the test year tax expenses. Unless there are extenuating circumstances, it is generally appropriate to use the same rate for the test year tax expense and for the gross-up factor because that is the best representation of tax expense. The gross-up factor is therefore reduced from 1.642 to 1.446. See Staff Exhibit No. 106, Schedule 1, for calculation details.

Q. Do you have any other adjustments relating to income taxes?

A. Yes. Another area that concerns Staff relates to the IRS audits I mentioned above. These tax audits can often result in additional tax payments made by Idaho Power. By its choice of test year, Idaho Power can propose to pass the costs associated with additional tax assessments to customers while enjoying the benefits of the lower taxes in other periods. In this rate case, Idaho Power is proposing to include in the revenue requirement $2.9 million dollars of additional tax payments relating to tax years 1998-2000. These tax payments associated with audited tax years need to better match the tax time frames for the audited years when the cost is included in rates. Customers should not be required to pay the additional tax payments when they did not enjoy the tax benefit in rates. Idaho Power knows when it will be audited and evaluates the total revenue requirement shortfall including the additional tax payments in its choice of the test year.

To more fairly match tax benefits and post-audit payments, Staff proposes to average the additional assessments in a manner similar to that used for the effective tax rates. This will continue to encourage Idaho Power to pursue aggressive tax positions and allow customers and Idaho Power alike to benefit. Because the IRS audits Idaho Power tax years every third year, with any large assessments appearing every three years, Staff proposes to average the assessments over three years. This will smooth out the additional payments for both the customers and Idaho Power. Staff also proposes to average the additional state income tax payments over three years. By averaging out the additional payments, Idaho Power will not lose its incentive to file its income taxes aggressively but will share benefits - not just additional payments - with ratepayers. In order to effect this adjustment, $1,960,529 should be removed from federal income tax test year expenses and $55,846 should be added to the state income tax amount Idaho Power requests to recover for the additional tax assessments. See Staff Exhibit No. 106, Schedule 3, for additional calculation details.

OTHER ITEMS

Q. Do you have any other adjustments to Idaho Power's test year?

A. Yes. During the year 2003, Idaho Power had three unusual cases before the Commission that were infrequent in nature and not likely to reoccur in the near future. In addition to utilizing internal Idaho Power employees, each of these cases required the use of outside consultants.

The first case I would like to address is the depreciation expense case (IPC-E-03-7). This was the first depreciation review since Idaho Power's last rate case approximately ten years ago. In this case, Idaho Power hired a depreciation expert at a cost of $21,772 (Staff Exhibit No. 107, line 1). In Case No. IPC-E-03-7, Staff recommended and the parties accepted by stipulation that Idaho Power file another depreciation study in five years to review those rates again.

The second case relates to Staff's investigation of the IDACORP Energy-Idaho Power relationship (IPC-E-01-16). This case has been complicated and lengthy but the issues involved are expected to be decided soon. On February 17, 2004, a Joint Motion and Stipulation were filed with the Commission to bring this case to an end. For this case, Idaho Power hired a consultant resulting in a cost of $53,228 during 2003 (Staff Exhibit No. 107, line 2).

Finally, Idaho Power has incurred expenses relating to the current rate case (IPC-E-03-13). During 2003, Idaho Power paid its expert witness, Dr. Avera, $24,720 for his work (Staff Exhibit No. 107, line 3).

All three of these cases are unusual in that they are infrequent and will not occur during a typical year. However, Idaho Power has included these additional costs in its pro forma expenses for the 2003 test year. It is not reasonable to assume that these cases will be repeated next year or each year in the near future. Therefore, the costs should not be reflected in a single year in their entirety as an annual cost. Staff proposes to amortize the expenses associated with these cases over five years instead of expensing them all at once. This will allow Idaho Power to recover the expenditures and customers to pay these costs only once instead of the total amount year after year until the next rate case. Staff proposes removing four-fifths of the outside consultants expense associated with each case to reflect this amortization. That results in a reduction of $79,776 to test year expenses. See Staff Exhibit No. 107 for calculation details.

Q. Did you review the adjustment for recovery of intervenor funding?

A. Yes. Idaho Power has requested recovery of $4,956 for intervenor funding paid during 2003 to the Land and Water Fund for the demand side management review case (IPC-E-01-16). Idaho Power's proposed recovery methodology would occur during 2004 and Idaho Power would continue to recover that amount every year after that until the next rate case. Staff proposes that the Commission allow Idaho Power to recover these costs over five years. This amortization allows Idaho Power to recover one-fifth ($991) of the expense in the test year.

Idaho Power was also ordered to pay intervenor funding to the Idaho Irrigation Pumpers Association, Inc. in the amount of $5,335 for its involvement in the 2003 PCA case (IPC-E-03-5). This case ended after Idaho Power had finalized its rate case filing and was not included in the test year. Staff proposes that the Commission allow Idaho Power to recover one-fifth of the amount ($1,067) in the test year. This adjustment will allow Idaho Power to recover its expense once rather than year after year until the next rate case. The net effect of these two adjustments is to reduce the revenue requirement by $8,067.

In the alternative, if the Commission wishes to grant a faster recovery of these two amounts, the 2004 Purchased Cost Adjustment (PCA) surcharge could be used as the method to recover these intervenor costs. This would allow Idaho Power to quickly recover these costs and only recover them once.

Q. Is there any other item you would like to discuss?

A. Yes. I have received many questions from customers and others regarding the relationship between Idaho Power and IDACORP. In every audit, Staff spends a great deal of time tracing transactions between the utility and its affiliates. In general, we were pleased that Idaho Power has implemented a system of tracking the flow of goods and services between IDACORP and its affiliates. The accounting system set in place seems to allocate costs and benefits between companies in a reasonable and effective manner. The executives appear to make an honest effort to appropriately assign their time to the different companies. For example during 2003, CEO Jan Packwood billed almost 86% of his time to entities outside of Idaho Power. That means Idaho Power customers will currently pay about 14% of his salary. Other employees use time reporting to allocate time, and therefore salaries and overhead expenses, between affiliates. Idaho Power conducts a study each year to determine if all costs are being allocated appropriately to its affiliated companies. These costs include insurance expense, special projects, and purchases from affiliates. Staff will continue to review the Idaho Power Company - IDACORP relationship and all affiliate transactions in every audit and rate case.

Q. Does this conclude your direct testimony in this proceeding?

A. Yes, it does.