BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION)
OF IDAHO POWER COMPANY FOR)
AUTHORITY TO INCREASE ITS RATES) CASE NO. IPC-E-07-8
AND CHARGES FOR ELECTRIC SERVICE)
TO ELECTRIC CUSTOMERS IN THE STATE)
OF IDAHO.)
)

IDAHO POWER COMPANY

DIRECT TESTIMONY

OF

JOHN R. GALE

Q. Please state your name and business address.

A. My name is John R. Gale and my business address is 1221 West Idaho Street, Boise, Idaho.

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

A. I am employed by Idaho Power Company (the Company) as the Vice President of Regulatory Affairs.

Q. Please describe your educational background and business affiliations.

A. I received a BBA in 1975 and an MBA in 1981 from Boise State University. I maintain a close affiliation with the university and serve on the College of Business and Economics' Advisory Council and on the Board of Directors of the Alumni Association. I have also attended the Public Utilities Executive Course at the University of Idaho.

I am an active member of the Edison Electric Institute's Rates and Regulatory Affairs Committee, which is the committee that is concerned primarily with regulatory issues and ratemaking methods. I am the current Vice Chair of this committee.

Q. Please describe your work experience.

A. From 1976 to 1983, I was employed by the State of Idaho primarily as an analyst in the Department of Employment. In October 1983, I accepted a position at Idaho Power Company as a Rate Analyst in the Rate Department. I initially worked on rate design, tariff administration, and line extension issues. In March 1990, I was assigned to the Company's Meridian District Office where I held the position of Meridian Manager, which was a one-year cross training position established to provide corporate employees with an extensive field experience. I returned to the Rate Department in March 1991 and in June I was promoted to Manager of Rates. In July 1997, I was named General Manager of Pricing and Regulatory Services. In March 2001, I was promoted to Vice President of Regulatory Affairs, my current position.

As Vice President of Regulatory Affairs, I oversee and direct the activities of the Pricing and Regulatory Services Department. These activities include the development of jurisdictional revenue requirements, the oversight of the Company's rate adjustment mechanisms, the preparation of class cost-of-service studies, the preparation of rate design analyses, and the administration of tariffs and customer contracts. In my current position, I have the primary responsibility for policy matters related to the economic regulation of Idaho Power Company. I have testified frequently before the Idaho Public Utilities Commission (the Commission) on a variety of rate and regulatory matters. I have also testified before or submitted direct testimony to the regulatory commissions in

Nevada and Oregon, the Federal Energy Regulatory Commission (FERC), and the United States Senate Committee on Energy and Natural Resources.

Q. What role did you play in the preparation of the general rate case?

A. My role in the preparation of the general rate case was to oversee, manage, and coordinate the filing and to make the policy decisions related to regulatory matters in consultation with Mr. LaMont Keen, our Company's President and Chief Executive Officer, along with other senior officers within Idaho Power.

Q. What was your interaction with the other Company witnesses?

A. I discussed the content and preparation of the witnesses' testimony and exhibits. Ms. Maggie Brilz (Director of Pricing), Mr. Greg Said (Manager of Revenue Requirement), and Mr. Barton Kline (Senior Regulatory Attorney) assisted me in this process. With each successive general rate filing during the 2000s, Ms. Brilz - in the area of rate design - and Mr. Said - in the area of revenue requirement - have increasingly assumed leadership roles in the development of Idaho Power Company's positions and recommendations related to their areas of responsibility.

Q. Please provide an overview of the Company's general rate case filing.

A. The Company begins the presentation of its case with Mr. LaMont Keen the Chief Executive Officer of the Company. He addresses Idaho Power's current financial situation and need for general rate relief.

The next witness is Mr. William Avera, who has been retained by the Company as the return on equity (ROE) expert. Mr. Avera also performed this function for Idaho Power in the last three general rate cases in Idaho and has also testified on the Company's behalf before the Oregon Public Utility Commission and the FERC. Mr. Avera discusses risk factors relevant to Idaho Power Company, performs calculations of ROE appropriate for the Company using standard financial methodologies, and recommends a reasonable ROE range appropriate for Idaho Power. In this proceeding, Mr. Avera's ROE range is from 11.2 to 12.2 percent.

Mr. Steven Keen, Idaho Power Company's Vice President and Treasurer, builds on Mr. Avera's recommendations by more specifically addressing the relevant risk factors impacting the Company. Mr. Keen selects an 11.5 percent ROE point estimate as the appropriate cost of equity, supports the cost of Idaho Power's long-term debt, and includes the long-term debt and the 11.5 percent ROE in the test year capital structure to derive the Company's proposed overall rate of return.

Ms. Lori Smith, the Company's Vice President of Finance and Chief Risk Officer, next testifies to the financial inputs that are the starting point for the 2007 test year. Ms. Smith describes the preparation of the test year forecast and the system adjustments to the test year data associated with deductions to certain expenses not allowed in rates, annualizing adjustments to expenses and rate base, and other adjustments to revenues, expenses, and rate base related primarily to past Commission orders.

Mr. Said provides the normalized net power supply expenses for the test year and addresses the requisite changes to the Company's Power Cost Adjustment (PCA) as a result of changing the normalized net power supply expenses in Idaho Power Company's base rates, including the Company's recommendation for the Load Growth Adjustment Rate incorporated in the PCA. Additionally, Mr. Said supports the calculation of offsetting revenues associated with the annualizing adjustments made to the test year. Mr. Said also testifies as to regulatory lag impacts on the Company's ability to earn its authorized return in 2008.

Ms. Celeste Schwendiman, a Senior Pricing Analyst, incorporates Ms. Smith's financial data, Mr. Steven Keen's overall rate of return recommendation, and Mr. Said's normalized net power supply expenses, along with other selected inputs and prepares the jurisdictional separation study (JSS). The JSS, as its name states, separates system values for rate base, revenues, and expenses for each state and the federal jurisdiction through an assignment and allocation process that is described in detail in Ms. Schwendiman's testimony. One result of the JSS is the Idaho retail jurisdictional revenue requirement, which is the Company's best representation of its expected annual cost to serve its Idaho retail customers. The 2007 Idaho jurisdictional revenue requirement is $681.8 million. In order to obtain this amount, Idaho's annual retail revenues will need to increase by $63.9 million or 10.35 percent.

Mr. Timothy Tatum, a Senior Pricing Analyst, uses the Idaho retail jurisdictional output from the JSS as developed by Ms. Schwendiman and further separates costs by customer class and special contract in preparing four class cost-of-service studies. Two of the studies prepared by Mr. Tatum present the more traditional cost-of-service approach used by Idaho Power in past proceedings, while the other two studies modify the traditional approach in a manner that allocates the costs of the Company's generation peaking facilities differently than its base-load resources. Of these four studies, Mr. Tatum recommends the approach termed "3CP/12CP" be used as the appropriate starting point for rate spread (the process of spreading the Idaho jurisdictional revenue requirement to the customer classes and special contract customers) and rate design (the ultimate calculation of rates for customers).

Ms. Brilz supports the Company's position on the appropriate rate spread to the customer classes and special contract customers and proposes price changes to the customer classes that are consistent with the Company's ratemaking objectives and that recover the Company's Idaho revenue requirement. Ms. Brilz also addresses changes to Idaho Power's General Rules and Regulations included in the Company's tariffs.

My testimony concludes the Company's direct case and focuses on the regulatory policy matters associated with this filing.

Q. What are the regulatory policy matters relevant to the Company's request?

A. In my view, the important regulatory policy decisions related to this general rate case filing are: (1) the selection of a forecast test year, (2) test year adjustments, (3) the rate spread approach, and (4) the rate design proposals. Of these, the most fundamental policy decision in the Company's filing is the decision to use a forecast test year. Because of the importance of this particular policy matter to the Company's financial health and ability to finance electric plant in the future, all other policy matters - *including* the forecast test year approach - have purposefully been undertaken with a conservative approach.

Q. What is the Company's test year?

A. The Company's test year is the 12 months ending December 31, 2007.

Q. Why did you choose 2007 as the test year?

A. Using a test year of 2007 to establish rates for 2008 provides the most recent information available as to the Company's expected expenses and investments, while enabling the Commission and parties to the case an opportunity to see how most of 2007 is actually developing in terms of investments and expenses prior to an order being issued.

Q. What distinguishes the approach taken in developing the 2007 test year proposed by the Company in this proceeding from the approach taken in 2003 and 2005?

A. In both 2003 and 2005, Idaho Power filed for general rate relief on test years that combined six months of actual information with six months of forecast information. This approach is commonly referred to as a "split test year". The 2007 filing is a full 12-month forecasted test year.

Q. Has the Company previously always filed a split test year?

A. No. To the best of my knowledge, 2003 was the first time that the Company filed with anything other than an historical test year. By historical test year I mean that all information was based on actual results. Certainly the two earlier filings with which I have personal knowledge - the 1983 and 1993 test years - were based on an historical test year.

Q. Why did the Company move to the split test year approach in 2003?

A. By 2003 Idaho Power could see the upward ramping of costs for a sustained period of time. It was becoming apparent that the combination of a growing customer base and higher marginal costs for most aspects of our business was going to push costs higher. In this environment, regulatory lag becomes a significant issue to the Company. The Company believed that moving to a full forecast test year at that time was too bold a step and instead chose the split year approach, which reduced regulatory lag by six months yet still provided access to the actual information prior to a final order by the Commission. Additionally, Idaho Power believed that the use of a split year could provide a bridge to a full forecast year in the future.

Q. Did the Company accomplish its regulatory objectives by using a six-month actual/six-month forecast test year in 2003 and 2005?

A. In part, Idaho Power was able to take a six-month bite out of regulatory lag by implementing rates on June 1, 2004 and June 1, 2006 that corresponded to cost periods beginning January 1, 2003 and January 1, 2005. On the other hand, the Company was not successful in either 2003 or 2005 in gaining the Commission's acceptance of the test year as filed as in both instances the forecast information was trued up to actual results as part of the rate determination. Essentially, the historical test year remained in place.

Q. Why is moving away from the use of a historical test year important?

A. Ultimately, Idaho Power needs a test year approach that is both timely and reflective of the costs that the Company can reasonably expect to incur going forward. An historical test year is by definition not timely and may not be a reflection of costs going forward. As an example of how actual costs might not be reflective of reasonably expected ongoing costs, one could look at Idaho Power's actual net power supply costs for almost any one year and conclude that - although the dollars may represent what actually occurred that year - it would not be appropriate for setting future rates. Similarly, a test year based on a reasonable forecast may be more indicative of the costs the Company will be experiencing during the time rates are in place.

Q. Why is regulatory lag such a critical issue to Idaho Power at this time?

A. To begin with, I would like to reiterate that it is important to more parties than just Idaho Power. As Mr. Keen notes in his testimony, it is also extremely important to those who invest and lend money to the Company testimony. From the Company's standpoint, during periods of escalating costs where marginal costs are higher than average costs, new rates are already inadequate by the time they go into place. This impact is pointed out in Mr. Said's testimony. If this situation continues for a prolonged period of time, the Company will be denied a reasonable opportunity to earn its authorized rate of return.

Q. Is regulatory lag always harmful to a utility?

A. No. The impact of regulatory lag is dependent upon the situation - if costs are not going up faster than rates, then the utility is not harmed and may even be helped by lag. Unfortunately, Idaho Power is not in that situation and will not likely be for the foreseeable future. Idaho Power rates - even with the split test year approach pursued in 2003 and 2005 - trail the start of the cost period they are intended to reflect by 17 months.

Q. Is the Company's approach to preparing its 2007 test year similar to its approach in preparing the 2005 test year used in the last rate case?

A. Yes it is. Idaho Power has taken the same approach to putting together the 2007 test year information as it did in putting together the 2005 test year, with the exception that the inputs are derived using 12 months of forecast data instead of six months of forecast data. Since the current filing comes so soon after the last general rate case, which in turn came quickly after the 2003 general rate case, it would be accurate to view this filing as a true-up of the Company's expenses and investments since 2005.

Q. Please describe the significant adjustments made to the 2007 test year.

A. The annualizing adjustments to rate base for 2007 are related to electric plant-in-service items closing to book during 2007. These items and their related impacts (such as depreciation and property tax) were included for the full 12 months. The Company has made its typical adjustments to the test year operating revenues consistent with previous Commission orders. Operating revenues are primarily restated through the normalizing adjustments to the Company's net power supply expenses as a result of multiple water conditions discussed by Mr. Said. Other known changes to tariffs or contracts were also included either in the test year revenues or adjustments to the test year. Sales revenues for the test year 2007 were based on estimated weather normalized retail sales for 12 months.

In response to the Commission's past directive to identify all increased revenues associated with annualized plant investment, Idaho Power proposes in Mr. Said's testimony a specific methodology to compute offsetting revenues in its 2007 test year for annualized plant items. A description of the methodology for computing offsetting revenues is contained in Mr. Said's testimony.

Q. Are there any additional decisions related to the development of the Company's revenue requirement that are of significance?

A. Yes, there are several decisions that are described and supported in Mr. Said's testimony that I believe warrant additional emphasis. The first is the inclusion of the Horizon Wind purchased power agreement and the additional purchased power agreements from Qualifying Facilities in the development of the Company's net power supply expenses. The Company's decision to include these reflects an expectation that these contracts will be a contributing part of the resource portfolio by the start of 2008. This decision is also a conservative one from a customer standpoint in that the net effect of including the contracts is to lower net power supply costs. The Company also took a conservative approach in its inclusion of Plant Held for Future Use, which is also described and supported by Mr. Said. This proceeding is the first instance Idaho Power has included these expenses since legislative changes have enabled the Commission to allow Plant Held for Future Use in rate base. The Company followed a prescribed and thoughtful approach in determining which properties to include in the test year.

Q. Turning to an adjustment that was not made, how did Idaho Power address pension costs in its 2007 test year?

A. In Idaho Power's 2003 general rate case, Order No. 29505 reduced Idaho Power pension plan expenses to zero and stated that the issue could be reevaluated in the next general rate proceeding (page 21). Because the circumstances have not materially changed, the Company has not made an adjustment to include a normalized level of pension costs for the 2007 test year. At some point in the intermediate future, Idaho Power will once again be making cash contributions related to funding pension costs. On or before that time, we will recommend to the Commission an appropriate ratemaking treatment of pension costs going forward; however, at this time there is no revenue requirement impact in the current filing related to pension expense.

Q. Do you believe the filed test year is representative of the Company's investments, revenues, and expenses and appropriate for ratemaking purposes?

A. Yes. I believe it is a reasonable estimate of the Company's cost to serve our Idaho retail customers and can be relied upon to set rates for the relevant time period beginning January 1, 2007 and will be understated for the time period beginning January 1, 2008.

Q. What has been Idaho Power's policy with regard to rate spread and rate design proposals?

A. Idaho Power has consistently advocated for rate spread among the customer groups and for component pricing within the customer groups to be primarily cost-based. Idaho Power's approach in this case is to once again spread the revenue requirement to the customer classes and special contract customers based upon cost-of-service results subject to some constraints on the total percentage impact to the customer groups. The specifics of the proposed rate spread and an exhibit delineating the target revenue requirements are contained in Ms. Brilz's testimony. Idaho Power's rate structure proposals in this case are purposefully not dramatic in light of the Company's forecast test year proposal and a series of other rate actions unrelated to the general rate case. However, as the officer responsible for regulatory matters, it is reasonable to expect that Idaho Power will evaluate existing and potential rate designs in light of Idaho Power's energy efficiency and conservation initiatives and wherever possible make proposals consistent with these initiatives in the next general rate filing.

Q. Idaho Power has stated on a number of occasions that the Company is in the middle of what may be a series of general rate actions. Why is this the case?

A. The Company has to address the rising capital and operating and maintenance costs associated with its service territory growth and replacement of existing infrastructure described by Mr. LaMont Keen and other Company witnesses. The Company also will be faced with the relicensing costs related to the Hells Canyon Complex, along with the implementation of its Integrated Resource Plan, which will necessitate investments in demand-side resources, supply-side resources, and transmission construction.

Compliance costs are increasing for Idaho Power and other utilities, as they must conform to the legal requirements of the Sarbanes-Oxley Act of 2002 (pertaining primarily to financial reporting) and the FERC's Standards of Conduct Rules (pertaining to interactions between a utility's energy affiliate business function and its transmission business function). Both of these new requirements increase costs through additional monitoring, auditing, and reporting as well as the separation - and sometimes duplication - of business functions.

Costs are also anticipated to increase as Idaho Power plans to maintain and improve its service to customers during a time when much of its workforce is reaching retirement age. To a large extent, we do not know now how these costs will manifest themselves - increasing competitive bidding for essential jobs, more extensive use of apprentice-type arrangements, dual filling of key positions, retention incentives (the reverse of early retirement programs), etc.

Q. What is the Company's regulatory strategy during this time of increasing costs?

A. As stated on a number of occasions, Idaho Power plans to file for rate relief more frequently and in smaller percentage terms than has been our custom in recent decades. This strategy will help the Company adjust revenues to keep pace with increasing costs, while avoiding the large increases that accumulate when rates are not kept current. Finally, from my standpoint, I would like to see some of the controversy removed from general rate cases through improved familiarity and understanding of the issues and the ability to reach some sustained resolution when possible.

Q. Is it your opinion that the granting of the rate relief proposed by the Company is in the public interest?

A. Yes.

Q. Does this conclude your testimony?

A. Yes, it does.