IDAHO POWER®
An IDACORP Company

BARTON L. KLINE
Senior Attorney

January 4, 2008

Jean D. Jewell, Secretary
Idaho Public Utilities Commission
472 West Washington Street
P. O. Box 83720
Boise, Idaho 83720-0074

Re: Case No. IPC-E-07-8
General Rate Case Filing

Dear Ms. Jewell:

Please find enclosed for filing an original and nine (9) copies of the Company's testimony and exhibits of William Avera, Steven R. Keen, Lori Smith, Gregory W. Said, Timothy Tatum, Maggie Brilz, Patrick Harrington, Jeff McCormick and John R. Gale along with one copy of each designated as the "Reporter's Copy." A compact disk containing the direct testimony and exhibits of the above-named Idaho Power Company witnesses is also enclosed.

The Company will send a copy of this filing to all parties on the attached Service List.

I would appreciate it if you would return a stamped copy of this letter for my file in the enclosed stamped, self-addressed envelope.

Very truly yours,

Barton L. Kline

BLK:sh
Enclosures

P.O. Box 70 (83707)
1221 W. Idaho St.
Boise, ID 83702

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 4th day of January, 2008, I served a true and correct copy of the within and foregoing document upon the following named parties by the method indicated below, and addressed to the following:

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Barton L. Kline

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IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

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

IDAHO POWER COMPANY

DIRECT REBUTTAL TESTIMONY

OF

John R. Gale

Q. Please state your name and whom you are representing.

A. My name is John R. Gale, commonly addressed as Ric Gale, testifying on behalf of Idaho Power Company ("Idaho Power" or "the Company").

Q. Are you the same Ric Gale that presented direct testimony before the Idaho Public Utilities Commission ("the Commission") in this docket?

A. Yes.

Q. Is your role in developing the Company's rebuttal testimony in this case the same as it was in the presentation of the direct case?

A. Yes. My role in the development of the Company's rebuttal testimony was to oversee, manage and coordinate the Company's rebuttal.

Q. Please identify the Company's rebuttal witnesses and summarize the issues they will address.

A. Mr. William Avera and Mr. Steven Keen will cover rate-of-return issues including the items Staff witnesses Carlock and English identified as risk-reducing factors. They will not address Staff's testimony concerning the Fixed Cost Adjustment ("FCA"), which I will cover because of my knowledge of the FCA and the process involved in putting it in place. Ms. Lori Smith will address the accuracy or reasonableness of the Company's 2007 forecast test year and the harmful economic impact to the Company if Staff's revenue requirement recommendations are adopted. She will also respond to the proposed disallowance of the capitalized pension amount and other Staff expense adjustments. The Company will introduce two new witnesses in rebuttal: Mr. Jeff McCormick, the Company's Audit Director, and Mr. Patrick Harrington, the Company's Corporate Secretary. Mr. McCormick will testify to the Company's audit processes and respond to a number of the issues raised by Staff witness Vaughn in her testimony. Mr. Harrington will respond to Staff's proposal to disallow certain legal expenses. Mr. Said will address revenue requirement issues, including the proper matching of revenues, expenses, and rate base. Mr. Said will also rebut the Staff and intervener positions on the Load Growth Adjustment Rate ("LGAR") in the Power Cost Adjustment ("PCA"). Mr. Tatum will address several misunderstandings intervener witnesses Peseau and Reading have regarding the Company's cost-of-service studies and speak to Idaho Power's willingness to explore other approaches. Ms. Brilz will rebut mischaracterizations by interveners regarding distributed generation and time-of-use pricing and will support cost-of-service as a starting point for rate design.

Finally, I will discuss the impact of regulatory lag, support the use of the forecast test year, address Staff's concerns with its ability to audit a forecast year, and address the need for a true-up when a forecasted test year is used.

Q. Have you read the direct testimony submitted by the Idaho Public Utilities Commission Staff and other interveners to this case?

A. Yes, I have read the testimony of all the Staff and intervener witnesses. However, my rebuttal testimony responds primarily to Staff witnesses Randy Lobb, Terri Carlock, and Donn English; Micron Technology witness Dennis Peseau; and Industrial Customers of Idaho Power witness Don Reading. Lack of a direct response on my part or the Company to other witnesses should not be construed as acceptance of their positions.

Q. Referring to Mr. Lobb's testimony, on page 9, he noted that the Company did not specifically define the term regulatory lag in its direct testimony. Please do so now.

A. I define regulatory lag as the difference between the time period when test-year costs are incurred and the time period when rates are implemented to recover those costs. A few examples of past Idaho Power filings should help illustrate regulatory lag. The Company filed a general rate case on June 30, 1994 based upon a test year ending December 31, 1993, Case No. IPC-E-94-5 ("the 94-5

Case"). Rates were implemented as a result of that docket on February 1, 1995. In the 94-5 Case there was a lag of 25 months from the start of the cost period (January 1, 1993 to December 31, 1993) to rate implementation. The Company filed its next general rate case on October 16, 2003, Case No. IPC-E-03-13 ("the 03-13 Case"). This filing was based upon six months of actual data January through June 30, 2003 and six months of forecast information for July through December 2003. Rates were implemented as a result of that docket on June 1, 2004 or 17 months after the start of the cost period. Our most recent general rate request, Case No. IPC-E-05-28 ("the 05-28 Case"), used a similar test year approach as the 03-13 Case.

Q. Please describe the regulatory lag for the two different test year proposals in this case.

A. The original schedule for this case would have produced a rate change in January 2008, so the Company's 2007 test year would have had rates in place 12 months after the start of the cost period. The Staff's proposed test year ending June 30, 2007 would have a corresponding 18-month lag between the start of the cost period and the implementation of rates. The Commission granted a Company-requested delay to this proceeding, which has added about 7 more weeks to the regulatory lag.

Q. Is regulatory lag economically helpful or harmful to a utility?

A. The economic impact of regulatory lag could be either helpful or harmful depending upon the circumstances in which a utility finds itself. As I stated in my direct testimony in this case, 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 be helped by lag. As I also stated in my direct testimony, Idaho Power is *not* currently experiencing the circumstances where regulatory lag is beneficial. Rather, Idaho Power is currently experiencing circumstances where regulatory lag is economically harmful.

Q. Mr. Lobb expressed his concern that the Staff should be able to view auditable information as part of their review of the reasonableness of a test year. Other Staff witnesses, including Ms. Carlock, echoed this concern. Please respond.

A. I take the expressed concerns seriously. During the discovery phase of the current case it became readily apparent that Staff wanted to evaluate the test year by looking at historic data, while it was our hope in the filing of our case that Staff would test the validity of the forecast. It is my contention that the correct test year for this case is the Company's proposed January 1, 2007 to December 31, 2007.

In future filings, I believe that we can accommodate both the Staff's desire to audit historical information and the Company's need to have a more current test year so that both goals can be obtained either through better understanding of the Company's forecasting methods or other forecasting alternatives. One potential alternative is to create a forecast test year through the escalation of data from a historical test year. The ultimate forecast may not be dramatically different than one produced by the method the Company used in this case, but there would be a starting point to audit.

Q. Why did you not use that approach for the 2007 test year?

A. Prior to making the filing, Idaho Power gave much thought to how it would present its initial forecast test year. Our conclusion was that the best data available is the same financial information that we use to manage the Company. Our rationale was that most of 2007 would be known at the time the Commission would issue an order. As it turned out, with the Company's requested scheduling delay, all of 2007 has occurred and actual 2007 data will soon be fully available. In short, the forecast test year we filed in this case is now in the past.

Q. On page 13 of his testimony, Mr. Lobb noted that reduced Company returns could increase borrowing costs that ultimately will raise customer rates; however, he believes that implementing a forecast test year might have a higher impact on customer rates than the increased financing costs. Please respond.

A. I trust that Mr. Lobb is not comparing a higher rate impact on customers (as a result of appropriately addressing regulatory lag) against increased financing costs (as a result of *not* appropriately addressing regulatory lag). In my mind that would be illegitimately improving the customers' short-term economic condition at the expense of the Company and its shareholders. If instead, Mr. Lobb is balancing potential overstated costs as a result of poor forecasting, it is my belief that the forecasting concerns of the Staff can be overcome in time through increased familiarity with the Company's forecast method, a different approach to developing the forecast, or through an inclusion of a subsequent true-up to actual rate base and expenses.

Q. In her direct testimony, Staff witness Carlock makes reference to and quotes from the *Bluefield* and *Hope* United States Supreme Court decisions which she represents as establishing the legal standards for determining fair and reasonable rates of return. Has the Idaho Supreme Court also addressed the legal standards to be applied by the Commission in setting just and reasonable rates?

A. Yes, I am aware of two cases, both of which involve the predecessor to Rocky Mountain Power, Utah Power & Light Company, in which the Idaho Supreme Court considered the legal standards applicable to establishing utility rates in Idaho. The first case, *Agricultural Products Corporation v. Utah Power & Light, and the Idaho Public Utilities Commission* (Ag Products Case) was decided in 1976. The second case, which involved *Utah Power & Light Company v. The Idaho Public Utilities Commission* (the Utah Power & Light Case), was decided in 1981. In the *Utah Power & Light* case, 102 Id. 282 (1981), the Court stated:

> "This Court's scope of review on appeal in cases of this type is to determine only if the Commission regularly pursued its authority and whether the constitutional rights of the utility were violated by the fixing of rates which were unjust, unreasonable and thus confiscatory." (Page 284).
>
> "Test year data should be adjusted for known and measurable changes where the changes are shown to be reliable and certain. 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." (Page 284).
>
> "Our purpose is not to analyze each step of the rate-setting process to determine whether the regulatory agency was correct in its decision, but to look at the overall effect of the rate fixed to determine whether the return to the utility is reasonable and just. As the Supreme Court of the United States stated in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944): "It is not theory but the impact of the rate order which counts. If the

total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important." (Page 286).

While I am not an attorney, I am familiar with the ratemaking concepts the Idaho Supreme Court discussed in these cases and my reading of these two cases indicates to me that the Commission must set rates to provide Idaho Power with a reasonable opportunity to be fairly compensated, taking into consideration Idaho Power's revenues and expenses and the investment that Idaho Power has made to provide electric service during the period of time that the proposed rates will be in effect.

Q. Are there any similarities between the utility load and resource conditions that existed when the *Ag Products* and *Utah Power & Light* cases were decided and today's conditions?

A. Yes, similar to the situation that exists today for Idaho Power, in the late 1970's and early 1980's Utah Power & Light's loads were growing rapidly and the costs of construction for new infrastructure were also increasing rapidly.

In the *Utah Power & Light* case, the Idaho Supreme Court found that if the utility's rate base and expenses were increasing faster than the utility's revenues, the Commission is obligated to determine an appropriate method to compensate for the detrimental effects of regulatory lag and ensure that the utility's rates would be sufficient during the period of time in which the rates would be in effect.

Q. Please refer again to Ms. Carlock's testimony on page 3 where she quoted from the United States Supreme Court decision in the *Bluefield Water Works* case. Is there language in that quotation that is pertinent to your testimony?

A. My focus is on the first part of the quotation contained in Ms. Carlock's testimony, which states, "A public utility is entitled to such rates as will permit it to earn a return on the value of the property…" I believe that the *Bluefield* case indicates that rates, costs, and returns have to be assessed in the relevant time period. If rising investments and expenses exceed rate changes upon their implementation, earnings are eroded and the opportunity to earn an authorized return is lost. This situation is compounded when the LGAR proposed by the Staff eliminates recovery of expenses necessarily incurred to serve load growth at a higher rate than the Company's average rate.

Q. If all the adjustments proposed by the Staff are adopted by the Commission, will Idaho Power have a reasonable opportunity to earn its authorized return?

A. No, putting aside whether the return on equity is 11.5 percent, 10.25 percent, or something else; to constitute just and reasonable rates, the application of the approved rates to the customer loads during the time period when the rates are in effect must give the Company a reasonable opportunity to earn whatever return is authorized. My concern with the totality of the Staff case is that Idaho Power will not have that opportunity under the current and near-term circumstances to earn whatever the Commission determines as the authorized return in this case.

Q. Paraphrasing Ms. Carlock's testimony on page 17, she stated that she does not believe a case has been made demonstrating the potential harm to the Company resulting from regulatory lag. Do you think that Ms. Carlock has accurately described the Company's case?

A. No. The harmful impact of regulatory lag was clearly demonstrated in the Company's direct case in the Company's Exhibit No. 31, the 2008 Jurisdictional Separation Study. Exhibit No. 31 shows that even if the full amount of rate relief requested by the Company was granted by the Commission, continued load growth and additions of new infrastructures would result in Idaho Power being immediately revenue deficient by $23.3 million in 2008. While I believe the Company demonstrated the adverse impact of regulatory lag in its direct case, in rebuttal, Mr. Said (through his Exhibit No. 66), Mr. Steven Keen (through his reporting of actual Company equity returns), and Ms. Smith (through her hypothetical and practical calculations) have all provided conclusive evidence of the harmful impact of regulatory lag as a result of the circumstances under which Idaho Power currently finds itself.

Q. Staff witness Kathy Stockton on page 21 of her testimony discussed the difficulty that Staff had in auditing the test year proposed by the Company, saying that it was difficult to obtain documentation from the Company in a timely manner. Please respond to her concern.

A. It is Idaho Power's intention to provide adequate, appropriate and timely responses to the Staff and other parties during the discovery phase of a regulatory proceeding. This intention was a major factor in our requested delay in the case schedule, so that the parties to the case could complete and digest the Company's rate case filing. Our discovery team is professional, experienced, and diligent. In the current proceeding, we have processed over 300 combined audit and data responses containing thousands of pages of information. The two different test year approaches taken by the Company and the Staff added another layer of complexity to an already labor intensive activity. We know that there were instances when the Company did ask Staff to narrow down what we considered overly broad requests. Idaho Power does not make these types of requests lightly or routinely, but only does so when the responses to the requests are extremely voluminous or time consuming. As an example, one audit request regarding backup information for work orders would have taken approximately 20 working days to answer as requested. We also know that there is a natural tension between the Staff's perception of our capabilities and our actual ability to deliver information within a tight time frame. The Company is committed to improving the discovery process going forward and will meet with Staff and others immediately following this proceeding to explore ways to improve the audit and data request process.

Q. Turning to Mr. English, to what area of his testimony will you be responding?

A. I will address the recommendation to lower the Company's rate of return because the Company has implemented the FCA.

Q. Briefly describe the FCA.

A. On January 27, 2006, Idaho Power filed an application and testimony favoring an annual Fixed-Cost Adjustment that "decouples" or separates utility sales from revenue in order to remove the economic disincentive for the utility to invest in energy efficiencies. On March 12, 2007, the Commission issued Order No. 30267 authorizing a three-year pilot of the FCA for residential and small general service customers. This true-up mechanism annually adjusts rates up or down to recover or refund the difference between the fixed costs authorized by the Commission in the previous general rate case and the fixed costs the utility actually recovers from customers during the calendar year.

Once this proposed rate mechanism is fully implemented, Idaho Power will be less impacted by decreases in energy sales, thus removing the disincentive for the Company to aggressively pursue opportunities to reduce electric consumption.

Q. Why are you addressing this matter instead of Mr. Steven Keen or Mr. Avera?

A. I have been the leading Company advocate of the FCA and have shepherded it through several years of workshops into its current implementation as a Commission-approved pilot program.

Q. Please respond to Mr. English's recommendation to reduce the Company's rate of return because of the implementation of the FCA.

A. I am troubled by this recommendation from a number of reasons. First, the FCA is a three-year pilot program that is just finishing its first year of existence. The pilot only applies to a subset of the Company's customers, residential and small general service.

Second, the FCA is a decoupling program that replaces one pricing mechanism with another, essentially a rate per customer for a rate per kilowatt-hour. One of the items to be gleaned from the pilot is to determine whether or not this is a better pricing mechanism. At the end of the third quarter of 2007, the FCA was actually recording a rate credit to the Idaho retail customers, thus making Idaho Power shareholders worse off than if the mechanism was not in place. I freely admit it is too soon to judge the ultimate merits of the FCA. It is also premature to start adjusting the Company's rate of return due to the presence of the FCA.

Third, the FCA was implemented in order to remove a disincentive to Company investments in energy efficiency and demand-side measures. Mr. English's recommendation is precisely why the environmental groups that participated in the workshops advocated that it does not make sense to remove one disincentive and create another one.

Q. Mr. English and Dr. Peseau both discussed an employee wage adjustment to reflect a test year incentive amount that is appropriate to include in the Company's revenue requirement. Please summarize their respective positions.

A. Mr. English adjusted the Company's payroll to reflect the targets as proposed by the Company, while noting that the target amount has increased from 3.5 percent in the 2005 test year to 4 percent in the current test year. He expressed a potential concern if the upward trend continues. On the other hand, Dr. Peseau proposes the disallowance of two-thirds of the target incentive on the basis that two of the components produce benefits that fall primarily to shareholders.

Q. Would you speak to Mr. English's concern regarding an increasing target levels for employee incentives?

A. In 2005, Idaho Power had just two components to the customer-based employee incentive, one for customer satisfaction and one for budget management. Both of these components were targeted at 1.75 percent for a total customer-based target incentive of 3.5 percent. The Company included the target amount in its 2005 revenue requirement in the 05-28 Case. The parties to the 05-28 Case ultimately settled the case and the Commission approved the settlement stipulation through Order No. 30035. The settlement included the following provision:

The parties agree conceptually that it is reasonable to include employee pay-at-risk or employee incentive component in test-year revenue requirements so long as such incentive component is based on goals that benefit customers and the amounts payable for achieving the goals are limited to reasonable "target" or medium goals. Senior management pay-at-risk is appropriately excluded from the test year revenue requirement.

The Company wanted to include an electric service reliability component when it originally set up the customer-based employee incentives; however, the Company could not establish a reasonable measure in time for 2005. Idaho Power was able to establish an electric service reliability incentive in 2006, thus increasing the customer-based components from two to three and expanding the total target percentage amount from 3.5 percent to 4 percent.

As an officer in the Company, I can report that the customer-based incentive piece for 2008 is also targeted at 4 percent and we have no plans at this time to change the target percentage in the future, although the whole incentive package is reviewed annually.

Q. Do you agree with Dr. Peseau's contention that two of the three incentive components included by Idaho Power in its test year are of primary benefit to the shareholders?

A. No. These components are customer-based incentives. I am in agreement with Dr. Peseau that shareholder-based incentives should be removed from revenue requirement and Idaho Power routinely removes any employee profit-related or earnings incentives from it test year. The Company also removes from its revenue requirement any incentives paid to or targeted for its senior management, whether shareholder-based or customer-based. Consistent with the 05-28 Case Settlement, only target levels of customer-based incentives are requested to be included in rates. As stated previously, these customer-based incentives are customer satisfaction, budget management, and reliability. Dr. Peseau proposes to remove from the test year the budget management and electric service reliability components. I believe we all could agree that budget discipline is an important management activity and an appropriate area to incent employees. In the current environment, in which the Company is in the position of managing rising costs to the best of its ability and filing rate cases every one to two years, the benefits of budget management are reflected in rates on an ongoing basis. Regarding electric service reliability, Dr. Peseau points to shareholder benefits in the form of lower power supply costs stemming from increased reliability. In discussing this conclusion with our operational personnel responsible for managing the reliability incentive, I found that there simply is not a relationship between network reliability and lower power supply costs. Further, even if Dr. Peseau's contention was true, such benefits would flow through to the

Idaho customers in the PCA.

Q. On page 9 of his testimony, in support of his argument that regulatory lag may not adversely impact utilities, Dr. Peseau refers to the hiatus of general rate case filings by Idaho Power Company prior to its filing of the 03-13 Case in 2003. Dr. Peseau concludes with a statement regarding his lack of awareness of any constraints on Idaho Power that might have impacted its ability to file for general rate relief. Please respond to Dr. Peseau's conclusion.

A. Idaho Power actually was constrained in its ability to file for general rate relief prior to 2003. Mr. LaMont Keen addressed these circumstances at length beginning on page 3 of his direct testimony in the 03-13 Case. At that time I had worked on that section of testimony with Mr. Keen and can speak to it now. As mentioned previously, Idaho Power filed the 94-5 Case in June of 1994 and the Commission issued its final order in February of 1995. Following the 94-5 Case, Idaho Power filed for the inclusion in rates of the Twin Falls hydroelectric plant upgrade, which the Commission authorized in August of 1995. This was essentially a single item rate matter that was incrementally added on to the recently completed 94-5 Case.

Also in 1995, the Commission approved a rate moratorium and earnings stability stipulation proposed by Idaho Power and various intervener parties, Case No. IPC-E-95-11. One of the provisions of the stipulation was that Idaho Power would not file for a change to base rates prior to January 2000. As many remember, the western energy crisis began to manifest itself in the second half of 2000 and into 2001. As a primary result of that crisis, Idaho Power had several annual PCA adjustments that were more than $200 million above base rates, representing rate increases that averaged more than 40 percent above base rates. Although Idaho Power did not have a legal or regulatory restriction on filing general rate increases in addition to these PCA rate changes, as a practical and political matter, it was simply not possible to do so.

Q. Dr. Peseau discussed forecast test years at length in his testimony in part by referring to his Exhibit No. 502, which is the Iowa Utilities Board report to the Iowa General Assembly entitled *Review of Utility Ratemaking Procedures* dated January 2004. In his testimony Dr. Peseau indicated that Exhibit No. 502 equates a historic test year with a "traditional" test year. Is that an accurate representation?

A. Dr. Peseau's testimony paraphrased sections of Exhibit No. 502 to draw an incorrect conclusion that the historical test year is the "traditional" test year. In fact the use of forecast test years has been common in numerous states since at least the 1970s. Idaho is surrounded by states, including Oregon, California, Utah, and Wyoming, that authorize their Commissions to adopt future test years to determine representative levels of revenues, expenses, rate base and capital structure. Accordingly, many utilities in these states are filing rate proceedings with forecast test years. The Oregon Commission has, for many years, viewed the future test year as the appropriate choice of test year. The Utah legislature has recently amended existing legislation and statutorily mandates that the Utah Commission give serious consideration to the adoption of the very same type of forecast test year period that Idaho Power is proposing in the instant case. Pacificorp uses the forecast test year in Oregon, Utah, and Wyoming to establish jurisdictional revenue requirement.

Commissions and policy makers throughout the country, and particularly in the West, are increasingly recognizing that in an era of heavy construction, future test years are necessary to allow utilities a reasonable opportunity to earn their authorized rate of return. Utilities that operate in a period of rapid expansion and rate base growth will chronically underearn if test years are historical in nature and fail to synchronize the matching of expenses and revenues.

Q. Dr. Peseau argued in his testimony that the states that routinely use a forward test year are almost exclusively "highly populous states with very large public commission staffs". He opined that the Idaho Staff is too small to properly administer a forward test year. Do you agree?

A. No, I would not characterize Wyoming, Utah, and Oregon as states that that are "highly populous states with very large public commission staffs". In researching the application of forward test years in the west, it is my understanding that the staff resource load is not increased, but rather the focus of the staff investigation changes.

For example, there are five members of the Public Service Commission of Wyoming staff assigned to the Rocky Mountain Power general rate request docket. In Oregon, the Public Utility Commission assigned approximately the same number of Staff to the 2005 Idaho Power rate case (which utilized a historic test year) as it did to the 2005 PacifiCorp rate case (which utilized a future test year). There also exists a classic Department of Energy study by R.E. Miller which reports that the future test year method has been found to reduce greatly the amount of time and personnel resources involved in a rate case and to extend the scope and quality of the analyses performed.

Q. Dr. Peseau spoke often in his testimony of the importance of the "matching" principal. Do you agree that the matching principal is important?

A. I agree that the effort to match investments, capital return, expenses, and revenue in a test year is an underlying principle that governs rate proceedings. However, I also believe it is critical that the period in which rates will be effective and the test year used to set rates match each other. That is the essence of the *Bluefield* case quotation contained in Ms. Carlock's testimony that I discussed previously.

In practice, in every rate case, a test year must be selected. Whether the test year selected is historical, future or some hybrid, the most important attribute of the selected test year should be that it accurately reflects the best expectation of the conditions that will prevail when the rates will be in effect. When future conditions are expected to significantly differ from historic experience, the only logical approach is to forecast all of the components of revenue requirement.

Idaho Power has developed a forecast from the bottom up, incorporated approved operating and capital budgets which are in fact used to manage the business, consistently applied assumptions and use of trends across all aspects of the forecast, and finally the forecast results compare to information provided to third parties. I am confident that in this instance a forecast test year is reasonable in light of the whole record and that the Company has reasonably demonstrated 100 percent of its capital and expense requests.

Q. In your testimony, you spoke of the use of the forecast test year as a tool to remove the detrimental effects of regulatory lag. While the Iowa Utilities Board in its report to the Iowa General Assembly (Micron Exhibit No. 502) recognized the eroding effects of regulatory lag on a utility's revenue stream, the Board chose not to recommend a future test year option. Please explain why.

A. In its investigation the Iowa Utilities Board found that most concerns regarding the negative effects of regulatory lag had been addressed by other Iowa statutes. In fact Iowa has numerous statutes or "tools" in place that exist to reduce the effect of regulatory lag. For example, Iowa allows for updates of infrastructure investment nine months beyond a test year and allows utilities to place temporary rates into effect without Board approval within ten days of a filing for a general rate increase. The Iowa Utilities Board has authority to allow for the automatic adjustment of rates and charges for sudden and volatile costs, and the Board has approved 100 percent recovery of fuel and transportation costs for electricity generation. In addition, the implementation of two new Iowa laws allowing regulatory assurances for capital investment decisions and for environmental improvements and the ability to consider cost of capital changes after the test year period go a long way to alleviate concerns related to regulatory lag in Iowa and therefore are useful regulatory "tools". These regulatory tools would be very helpful to have in Idaho given the current and forecasted energy and economic situation.

Q. Dr. Peseau objects to the use of forecast test years because he believes that utilities will be tempted to abuse the system. He calls this "systemic bias". This Commission has often approved the use of a historical test year adjusted for known and measurable changes. Does a historical test year always produce a totally objective and unbiased revenue requirement?

A. No. Every type of test year is subject to criticism and objection if a rate increase is proposed. When an historical test year is proposed, the arguments would simply shift from issues surrounding forecasting technique to the choice of known and measurable adjustments. Utilities are often criticized in their choice of an historic test year; opponents argue that the utility has an incentive to exaggerate its costs in the period under review. Every type of test year has its advantages and challenges. Fortunately the standard for setting rates in

Idaho is not perfection, as the Idaho Supreme Court noted in the *Utah Power & Light* case I quoted earlier.

Idaho Power is not asking for a blanket acceptance of its forecast calculations but rather acceptance of the concept of a forecast test year as being an appropriate tool to provide timely recovery for the increased level of expenditures that are required to serve the growing Idaho load.

Q, Dr. Peseau likens the forecasts required of a future test year to audacious divining of the future. Do you agree?

A. No. Regardless of which test year is adopted, the ratemaking process is inherently prospective and requires reliance upon projections. Whether the test year is completely historical or based totally on forecasted results, the ratemaking process requires an informed determination of what conditions will prevail in the future. Idaho Power has used its best financial and operational information to construct its forecast test year and is well aware that it is putting its credibility on the line. Beginning with this rate filing, Idaho Power believes it can establish its ability to present reliable test year forecasts that will result in just and reasonable rates. While Dr. Peseau may argue that perfection is the ultimate goal with regard to forecasting, Idaho Power's goal is considerably less lofty. Our goal is the production and support of a reliable and reasonable test year forecast that provides the Commission with information needed to establish just and reasonable rates.

Goals aside, the fact remains that the volatile environment in which electric utilities operate today and the increasingly capital intensive nature of their business, indicates the need for new solutions, including a reexamination of a regulatory process that would reject the use of forecast test years in order to preserve the concepts of comfort, convenience and administrative ease.

Q. Let's now move on to Dr. Reading's forecast test year concerns. Beginning on page 2 of his testimony, Dr. Reading notes that in the current case the Company departed from prior practice by filing a full 12-month forecast test year, while in the previous two cases, the Company filed a six-month actual and a six-month forecast test year. He points out in his testimony that in prior cases the six months of forecast were "trued-up" at the end of the case. Was it Idaho Power's proposal in either of these prior cases to true-up the forecast periods?

A. No. The Company's test year proposal in both instances was six-months actual and six-months forecast. There was no proposal to true-up the forecast data. We realized of course that the Commission would have the benefit of seeing actual plant and expense information for the six-months of forecast data and taking that information into consideration before issuing a final order. However, it was not our proposal and we never proposed that it was necessary to true up either test year. Ultimately the inclusion of more recent plant and expense data in the final order of the 03-13 Case and the 05-28 Case Settlement were not objectionable to the Company.

Q. What is the Company's position on the notion of a true-up to the proposed forecast test year?

A. I do not think that a true up of forecast information is needed to set rates that are reflective of the costs expected to be incurred during the time that the rates are in place. Knowing how often the Company will be before this Commission over the next five years, we concluded that unreasonably inaccurate forecasting would become readily apparent to all the parties. With the challenge we have to earn authorized returns, any incentive to "game" the forecast would be short-term gain and long-term folly. However, as a practical matter, if true-ups provide a comfort level to the Commission and customers that would allow the Commission to accept a full forecast test year, then Idaho Power stands quite ready to accept the symmetrical application of a true-up to a forecast test year.

Q. Please summarize Idaho Power's rebuttal position to the collective recommendations of the Staff.

A. This is Idaho Power's third general rate case since 2003. We are planning a 2008 filing at this writing and see the need for additional general rate cases in the next several years as we meet the challenges of both our industry and our service territory. As a result our operations and results will be very transparent to both the Commission and customers. The Company is seeking a reasonable opportunity to earn its authorized rate of return during this time period. It is the Company's opinion that this opportunity can be best achieved through use of the forecast test year proposed - January 1, 2007 to December 31, 2007 - to decrease the time period between cost incurrence and rate implementation, and the establishment of a moderate LGAR that will also allow the Company to better match power supply expenses with PCA rate recovery.

Q. Have you concluded your direct rebuttal testimony?

A. Yes.