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IDAHO PUBLIC
UTILITIES COMMISSION

December 7, 2007

VIA FEDERAL EXPRESS

Ms. Jean Jewell
Commission Secretary
Idaho Public Utilities Commission
P.O. Box 83720
Boise, ID 83720-0074

RE: Case No. IPC-E-07-8

Dear Ms. Jewell:

Enclosed please find an original and ten (10) copies of the Direct Testimony and Exhibits of Matthew I. Kahal on Behalf of the United States Department of Energy, and ten (10) copies of the Direct Testimony and Exhibits of Dennis W. Goins on Behalf of the United States Department of Energy in the above-captioned proceeding. Also enclosed is an additional copy of each of these items that I request be date-stamped and returned in the enclosed stamped envelope. If you have any questions concerning this filing, please do not hesitate to contact me at (202) 586-3409.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Arthur Perry Bruder".

Arthur Perry Bruder
Attorney-Advisor
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United States Department of Energy
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IDAHO PUBLIC
UTILITIES COMMISSION

STATE OF IDAHO

BEFORE THE

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

DIRECT TESTIMONY OF

MATTHEW I. KAHAL

ON BEHALF OF THE

U.S. DEPARTMENT OF ENERGY

DECEMBER 10, 2007

EXETER

ASSOCIATES, INC.

5565 Sterrett Place

Suite 310

Columbia, Maryland 20904

TABLE OF CONTENTS

| | <u>PAGE</u> |
|---|-------------|
| I. QUALIFICATIONS | 1 |
| II. OVERVIEW | 3 |
| A. Summary of Recommendations | 3 |
| B. Capital Cost Trends..... | 6 |
| C. Cost of Equity Summary..... | 9 |
| D. Testimony Organization..... | 11 |
| III. COST OF COMMON EQUITY..... | 12 |
| A. Using the DCF Model..... | 12 |
| B. DCF Study Using the West Region Group of Electric Utility Companies..... | 16 |
| C. DCF Sensitivity..... | 22 |
| D. Dr. Avera's DCF Estimates | 23 |
| IV. REVIEW OF DR. AVERA'S DCF, CAPM AND COMPARABLE EARNINGS..... | 26 |
| A. DCF Analysis..... | 26 |
| B. CAPM Results | 27 |
| C. Comparable Earnings..... | 32 |
| V. CONCLUSIONS ON FAIR RATE OF RETURN | 35 |

1 **I. QUALIFICATIONS**

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is Matthew I. Kahal. I am employed as an independent consultant
4 retained in this matter by the firm of Exeter Associates, Inc. My business address
5 is 5565 Sterrett Place, Suite 310, Columbia, Maryland 21044.

6 Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND.

7 A. I hold B.A. and M.A. degrees in economics from the University of Maryland and
8 have completed all course work and qualifying examination requirements for the
9 Ph.D. degree in economics. My areas of academic concentration included
10 industrial organization, economic development and econometrics.

11 Q. WHAT IS YOUR PROFESSIONAL BACKGROUND?

12 A. I have been employed in the area of energy, utility and telecommunications
13 consulting for the past 30 years working on a wide range of topics. Most of my
14 work has focused on electric utility integrated planning, plant licensing,
15 environmental issues, mergers and financial issues. I was a co-founder of Exeter
16 Associates, and from 1981 to 2001 I was employed at Exeter Associates as a
17 Senior Economist and Principal. During that time, I took the lead role at Exeter in
18 performing cost of capital and financial studies. In recent years, the focus of much
19 of my professional work has shifted to electric utility restructuring and
20 competition.

21 Prior to entering consulting, I served on the Economics Department
22 faculties at the University of Maryland (College Park) and Montgomery College
23 teaching courses on economic principles, development economics and business.

24 Q. HAVE YOU PREVIOUSLY TESTIFIED AS AN EXPERT WITNESS
25 BEFORE UTILITY REGULATORY COMMISSIONS?

1 A. Yes. I have testified before approximately two-dozen state and federal utility
2 commissions in more than 300 separate regulatory cases. My testimony has
3 addressed a variety of subjects including fair rate of return, resource planning,
4 financial assessments, load forecasting, competitive restructuring, rate design,
5 purchase power contracts, merger economics and other regulatory policy issues.
6 These cases have involved electric, gas, water and telephone utilities. In 1989, I
7 testified before the U.S. House of Representatives, Committee on Ways and
8 Means, on proposed federal tax legislation affecting utilities.

9 Q. WHAT PROFESSIONAL ACTIVITIES HAVE YOU ENGAGED IN
10 SINCE LEAVING EXETER AS A PRINCIPAL IN 2001?

11 A. Since 2001, I have worked on a variety of consulting assignments pertaining to
12 electric restructuring, purchase power contracts, environmental controls, cost of
13 capital and other regulatory issues. Current and recent clients include the U.S.
14 Department of Justice, U.S. Air Force, U.S. Department of Energy, the Federal
15 Energy Regulatory Commission, Connecticut Attorney General, Pennsylvania
16 Office of Consumer Advocate, New Jersey Division of Counsel, Rhode Island
17 Division of Public Utilities, Louisiana Public Service Commission, Arkansas
18 Public Service Commission, Maryland Department of Natural Resources and
19 Energy Administration, and Maine Office of the Public Advocate.

20 Q. HAVE YOU PREVIOUSLY TESTIFIED IN MATTERS BEFORE THIS
21 COMMISSION?

22 A. Yes. I have testified on cost of capital before the Idaho Public Utilities
23 Commission on previous occasions, including Idaho Power Company's (IPC or
24 the Company) base rate case in 1994 (IPC-E-94-5).

1 **II. OVERVIEW**

2 **A. Summary of Recommendations**

3 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS
4 PROCEEDING?

5 A. I have been asked by the U.S. Department of Energy (DOE) to develop a
6 recommendation concerning the fair rate of return on the jurisdictional electric
7 utility rate base of Idaho Power Company (IPC or the Company). IPC is the
8 electric utility subsidiary of IdaCorp, Inc., and it accounts for the vast majority of
9 IdaCorp's invested capital and operations. My work in this case includes both a
10 review of the Company's proposal concerning rate of return and the preparation
11 of an independent study of the cost of common equity.

12 Q. WHAT IS THE COMPANY'S RATE OF RETURN PROPOSAL IN
13 THIS CASE?

14 A. As presented on Exhibit 10 sponsored by Mr. Keen, the Company proposes an
15 overall rate of return of 8.56 percent, based on the projected capitalization and
16 debt costs at December 31, 2007. The capital structure proposed in this case
17 includes 50.3 percent common equity and 49.7 percent long-term debt, with no
18 preferred stock or short-term debt included in the capital structure. The requested
19 overall rate of return is sponsored by the Company witness, Mr. Steven Keen, and
20 he selects a return on common equity of 11.5 percent. IPC's outside cost of
21 capital witness, Dr. William Avera, recommends a return on common equity
22 range of 11.2 to 12.2 percent.

23 Q. WHAT IS MR. KEEN'S APPROACH TO CAPITAL STRUCTURE?

24 A. IPC is a wholly owned subsidiary of IdaCorp, Inc., a utility holding company, and
25 is principally engaged in electric utility retail operations in Idaho, with a small

1 amount of retail utility operations in Oregon. Mr. Keen bases the ratemaking
2 capital structure on the projected Idaho Power Company capital structure at
3 December 31, 2007. As of this date, IPC expects to have no preferred stock
4 outstanding, and Mr. Keen includes the effects of expected long-term debt
5 issuances.

6 Mr. Keen also provides an estimate of the actual embedded cost of debt,
7 inclusive of the prospective cost rates for the Company's variable rate debt and its
8 projected new debt issuances. This produces an embedded cost of debt of
9 5.59 percent.

10 Q. WHAT IS YOUR RECOMMENDATION AT THIS TIME ON RATE OF
11 RETURN?

12 A. As presented on my Exhibit No. 601, I am recommending a return on the IPC
13 jurisdictional rate base of 7.93 percent, which includes a 10.25 percent return on
14 common equity. The 10.25 percent recommendation is based primarily upon
15 discounted cash flow (DCF) evidence using a proxy group of eleven electric
16 utility companies operating in the West Region of the U.S. I also present DCF
17 evidence using a subset of Dr. Avera's proxy companies, i.e., those companies in
18 his group that operate as integrated, fully-regulated utilities. In addition, I have
19 reviewed and considered Dr. Avera's evidence using the Capital Asset Pricing
20 Model (CAPM), although I find the CAPM to be much less useful than the DCF
21 studies. Finally, I compare my DCF results to "comparable earnings" evidence,
22 although this is not a market cost of equity estimation method. The 10.25 percent
23 is somewhat higher than my DCF midpoint results, providing IPC with a premium
24 over the "baseline" proxy group cost of equity estimate.

1 In formulating my overall rate of return recommendation, I have accepted
2 the Company's proposed December 31, 2007 capital structure, subject to possible
3 updating. This capital structure provides IPC with a slightly thicker equity ratio
4 than approved by the Commission in the 2004 rate case, and these percentages
5 appear to be consistent with IPC's financial objectives.

6 Q. WHAT RATE OF RETURN DID THE COMMISSION APPROVE IN
7 THE LAST FULLY-LITIGATED RATE CASE?

8 A. In IPC's last fully-litigated case, decided in 2004 (Case No. IPC-E-03-13, May
9 25, 2004), the Commission set the Company's rate of return on equity (ROE) at
10 10.25 percent, in conjunction with a common equity ratio of 46 percent. In that
11 rate order, the Commission concluded that the authorized 10.25 percent return on
12 equity appropriately reflected the Company's business risks. The Commission's
13 return on equity quantification in that Order relied primarily on DCF and
14 comparable earnings evidence. (Order, page 38)

15 I recommend that the Commission reaffirm and continue the 10.25 percent
16 common equity award. This return is consistent with the cost of capital evidence
17 at this time, provides IPC with at least a small premium over my "base line" DCF
18 results, and is also generally consistent with the comparable earnings evidence.
19 Moreover, the 10.25 percent return would be applied to a larger common equity
20 base in this case (50 percent) as compared to the 2004 case (46 percent).

21 Q. WHAT IS THE ASSESSMENT OF IPC BY THE RATING AGENCIES?

22 A. As summarized in Mr. Keen's testimony, all three credit rating agencies rate IPC
23 high triple B, low single A, with the low single A applicable to the Company's
24 secured debt. The recent reports from the three major credit rating agencies
25 (Standard & Poors, Moody's and FitchRatings) were provided in response to

1 DOE's first set of data requests, item 21, and all three organizations provide
2 generally similar business risk assessments. For example, FitchRatings notes the
3 "beneficial effects of the utility's power cost adjustment mechanism and a
4 reasonable regulatory environment." (June 15, 2007) Standard & Poors identifies
5 the strengths as being "a strong power cost adjustment (PCA) mechanism,"
6 supportive regulation, low-cost generation and the absence of unregulated
7 business. (February 8, 2006) Moody's refers to IPC's "generally low business
8 risk profile", reasonably supportive regulatory treatment and the power cost
9 adjustment mechanisms as being positive for ratings. (May 11, 2007)

10 Similarly, each of the three credit rating agencies mentions the same
11 negative factors. The principal rating concerns include IPC's large construction
12 program (including the risks of rate disallowances) and the risk of adverse
13 hydrologic conditions. It appears that S&P indicates a negative outlook due to the
14 high capital spending.

15 Q. WHAT DO YOU CONCLUDE?

16 A. Based on my review of the information submitted in this case, including the
17 recent credit rating reports, I conclude that IPC is an approximately average risk
18 electric utility. Thus, the West Region group of vertically-integrated electric
19 companies provide a generally reasonable risk proxy for IPC.

20
21 B. Capital Cost Trends

22 Q. HAVE YOU REVIEWED THE TRENDS IN MARKET CAPITAL
23 COSTS OVER THE PAST DECADE?

24 A. Yes. My Exhibit No. 602 shows capital cost indicators on an annual basis since
25 1992 and on a monthly basis during January 2002 to September 2007. The

1 indicators include inflation (as measured by the annual change in the Consumer
2 Price Index), short-term Treasury yields, ten-year Treasury yields and single A-
3 rated long-term utility bond yields (per Moody's).

4 This schedule shows that despite year-to-year fluctuations there has been a
5 downward trend in capital costs over this time period, at least for long-term
6 securities. Short-term interest rates tend to be governed by Federal Reserve (Fed)
7 policy, and during the last two years the Fed has been "tightening" (i.e., raising
8 short-term rates) in response to a strengthening U.S. economy. In response to a
9 slowing U.S. economy and distress in the housing market the Fed very recently
10 has reversed this trend and begun to reduce interest rates. As measured by utility
11 bond yields, it appears that capital costs "bottomed out" in mid-2005, with single
12 A utility bond yields reaching a low point in the mid 5 percent range. Long-term
13 interest rates remained relatively low through most of 2006 (i.e., long-term utility
14 bond yields at approximately 6 percent), and this has continued during most of
15 2007. Long-term rates can move from month-to-month but the underlying trend
16 has been fairly stable. Single A utility bond yields have remained in the 6.0 to
17 6.5 percent range, with Ten-Year Treasury yields in the 4.5 to 5.0 percent range.

18 Based on my review of this information, I would characterize the capital
19 cost environment as remaining quite favorable compared to past years. Capital
20 costs during most of 2007 also appear to be favorable compared to the costs in
21 late 1990s.

22 Q. ACCORDING TO EXHIBIT NO. 602, THERE WAS AN UPWARD
23 MOVEMENT IN INFLATION IN 2006. PLEASE COMMENT.

24 A. Inflation rates during the 2006 moved upwards in response to price spikes for
25 energy. However, the underlying "core" inflation (excluding the volatile fuel and

1 food sectors) remains relatively stable. For example, the long-term “consensus”
2 forecast of the GDP Deflator (Blue Chip Economic Indicators, March 10, 2007)
3 is 2.1 percent annually. The favorable “core” inflation outlook is based on strong
4 productivity growth in the U.S. economy, the expansion of global competition
5 which tends to hold down increases in U.S. product prices and Fed monetary
6 policy that emphasizes inflation control.

7 Q. YOUR EXHIBIT NO. 602 PROVIDES DATA ON LONG-TERM
8 INTEREST RATES. IS THIS INDICATIVE OF COMMON EQUITY
9 COST RATES?

10 A. At least in a general sense, I believe it is. The forces over time that lead to lower
11 yields on long-term debt also favorably affect the cost of equity, although I would
12 acknowledge that equity and debt cost rates do not necessarily move together in
13 lock step. The favorable trends over time in long-term debt cost rates are also
14 likely to affect IPC’s equity cost rate for providing electric service.

15 There is another force at work that further contributes to a reduced cost
16 rate for equity -- federal tax policy. In mid-2003, Congress enacted legislation
17 granting favorable income tax treatment for dividend payments and capital gains.
18 (Legislation extending this favorable tax treatment was enacted by Congress last
19 year.) Lower taxes on returns to equity investments mean that investors are
20 willing (or should be willing) to accept lower returns for holding common stocks
21 (such as those of electric and other utilities), particularly as compared with bonds,
22 which do not enjoy this benefit. The DCF method, which uses relatively current
23 market data, can fully capture this effect. Other methods, such as historical risk
24 premium method (as used by Dr. Avera), may not be able to do so.

25

1 C. Cost of Equity Summary

2 Q. HOW DID DR. AVERA OBTAIN HIS RECOMMENDED COST OF
3 EQUITY RANGE?

4 A. Dr. Avera emphasized two cost of capital methodologies, the DCF and the
5 CAPM, and he also employed comparable earnings evidence, a method which
6 does not directly measure the cost of equity. He reports the following results:
7

| Dr. Avera's ROE Summary | | |
|-------------------------|----------------------|---------------|
| 1. | DCF | 10.4 to 12.4% |
| 2. | CAPM | 11.5 - 12.8% |
| 3. | Comparable Earnings | 11.0% |
| 4. | Flotation Cost Adder | 0.2% |
| Source: Avera, page 59 | | |

8

9 Dr. Avera concludes that this evidence supports a "bare bones" cost of
10 equity range of 11.0 to 12.0 percent based on these methods. He then adds 0.2
11 percentage points to recover "historical" flotation costs incurred by IPC (or by its
12 parent on behalf of IPC), thereby producing a final range of 11.2 to 12.2 percent.

13 Q. WHAT ARE YOUR COST OF EQUITY RESULTS?

14 As mentioned earlier, my recommendation (before considering the need
15 for an IPC premium) is based primarily on the DCF evidence. I have applied the
16 DCF model to a proxy group of eleven West Region electric utility companies.
17 This group is very similar to the proxy group used by Dr. Avera in the 2004 rate
18 case. This analysis produces a range of 9.3 to 10.3 percent with a midpoint of 9.8
19 percent. Excluding two members of that group with Value Line Safety Ratings
20 of "1" (the most favorable rating), the range becomes 9.6 to 10.3 percent, with a

1 midpoint of about 10.0 percent. Dr. Avera's own DCF evidence, based on a
2 subset of integrated electric utilities operating in "non-restructured" states,
3 support a DCF estimate in the range of about 9 to 10 percent. This is shown on
4 my Exhibit No. 604, pages 1 and 2, and on Exhibit No. 605.

5 I also present evidence on comparable earning as additional background
6 information for the Commission. The recent historical and projected earned
7 returns for risk comparable companies are generally in the 9 to 10 percent range,
8 on average, or somewhat higher.

9 Considering this cost of capital evidence, I believe a reasonable range for
10 the "base line" cost of equity would be about 9.5 to 10.5 percent, with the best
11 evidence supporting returns toward the lower end of this range. Hence, my
12 recommendation of 10.25 percent is consistent with this baseline result plus a
13 small return premium for IPC.

14 Q. HAVE YOU INCLUDED AN ADJUSTMENT FOR COMMON STOCK
15 ISSUANCE COSTS?

16 A. No, I have not done so since there is no indication of any current or near-term
17 plans by IdaCorp to conduct a public issuance of common stock. The last such
18 public issuance occurred in 2004. However, Dr. Avera's evidence would support
19 an "adder" to the baseline cost of equity of only about 0.1 percent (assuming any
20 adjustment factor flotation is appropriate), and therefore would not alter the
21 reasonable range of about 9.5 to 10.5 percent.

1 **D. Testimony Organization**

2 Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

3 A. Section III presents my DCF evidence based on the application of that model to
4 the West Region electric utilities. Section IV is my reply to Dr. Avera's cost of
5 equity evidence. In presenting that reply I discuss his DCF evidence, Capital
6 Asset Pricing Model (CAPM) studies and his comparable earnings data. In
7 Section IV, I present alternative comparable earnings information. Finally,
8 Section V presents a summary of my conclusions and recommendations.

1 **III. COST OF COMMON EQUITY**

2 **A. Using the DCF Model**

3 Q. WHAT STANDARD ARE YOU USING TO DEVELOP YOUR
4 RETURN ON EQUITY RECOMMENDATION?

5 A. As a general matter, the ratemaking process is designed to provide the utility an
6 opportunity to recover its prudently-incurred costs of providing utility service to
7 its customers, including the reasonable costs of financing its used and useful
8 investment. Consistent with this "cost-based" approach, the fair and appropriate
9 return on equity award for a utility is its cost of equity. The utility's cost of equity
10 is the return required by investors (i.e., the "market return") to acquire or hold that
11 Company's common stock. A return award greater than the market return would
12 be excessive and would overcharge customers for utility service. Similarly, an
13 insufficient return could unduly weaken the utility and impair incentives to invest.

14 Although the concept of the cost of equity may be precisely stated, its
15 quantification poses challenges to regulators. The market cost of equity, unlike
16 certain other utility costs, cannot be directly observed (i.e., investors do not
17 directly, unambiguously state their return requirements), and it therefore must be
18 estimated using analytic techniques. The DCF model is one such technique
19 familiar to analysts and this Commission and was relied upon in IPC's last fully-
20 litigated rate case.

21 Q. IS THE COST OF EQUITY A FAIR RETURN AWARD FOR THE
22 UTILITY AND CUSTOMERS?

23 A. Generally speaking, I believe it is. A return award commensurate with the cost of
24 equity generally provides fair and reasonable compensation to utility investors
25 and normally should allow efficient utility management to successfully finance its

1 operations on reasonable terms. Certainly, this has been the case for IPC based on
2 the 10.25 percent equity return granted by the Commission in its last rate case in
3 2004. Setting the return on equity equal to a reasonable estimate of the cost of
4 equity also is fair to ratepayers.

5 I recognize that there can be exceptions to this general rule. For example,
6 in some instances, utilities have sought rate of return adders as a reward for
7 asserted good management performance. In this case, the Company is seeking a
8 return on equity that approximates the midpoint of Dr. Avera's cost of equity
9 range. Mr. Keen further justifies the 11.5 percent request (an increase of
10 125 basis points or about 12 percent compared to the 10.25 percent previously
11 awarded) on business risks that IPC currently faces.

12 Q. WHAT DETERMINES A COMPANY'S COST OF EQUITY?

13 A. It should be understood that the cost of equity is essentially a market price, and as
14 such, it is ultimately determined by the forces of supply and demand operating in
15 financial markets. In that regard, there are two key factors that determine this
16 price. First, a company's cost of equity is determined by the fundamental
17 conditions in capital markets (e.g., outlook for inflation, monetary policy, changes
18 in investor behavior, investor asset preferences, etc.). The second factor (or set of
19 factors) is the business and financial risks encountered by the utility in question.
20 For example, the fact that a utility company effectively operates as a regulated
21 monopoly, dedicated to providing an essential service (in this case electric utility
22 service), typically would imply low business risk and therefore a relatively low
23 cost of equity, as compared to most unregulated companies operating in
24 competitive markets.

1 Q. DOES DR. AVERA INCORPORATE THESE PRINCIPLES?

2 A. In general, he attempts to incorporate these principles in conducting his DCF and
3 CAPM analyses. However, I disagree with his recommendation of a return on
4 equity that is 125 basis points higher than that granted by the Commission in
5 2004. Moreover, I question whether his two "risk premium" analyses (i.e.,
6 CAPM studies) realistically measure the cost of equity, and I also question his use
7 of unregulated companies as being appropriate "risk proxies" for the fully-
8 regulated IPC.

9 Q. WHAT METHODS ARE YOU USING IN THIS CASE?

10 A. I employ both the DCF and comparable earnings methods, applied to a proxy
11 group of electric utility companies to obtain a "baseline" cost of equity.
12 However, for reasons discussed in my testimony, I emphasize the DCF model
13 results in formulating my recommendation. It has been my experience that most
14 utility regulatory commissions (federal and state) heavily emphasize the use of the
15 DCF model to determine the cost of equity when setting the fair return. While I
16 do not rely on the CAPM, the next section of my testimony provides a discussion
17 of this method and Dr. Avera's application of it.

18 Q. PLEASE DESCRIBE THE DCF MODEL.

19 A. As mentioned, this model has been widely used in the regulatory community,
20 including by this Commission. Its widespread acceptance is due to the fact that
21 the model is market-based and is derived from standard and accepted
22 economic/financial theory. The model is transparent and readily understandable.

23 The DCF theory begins by recognizing that any publicly-traded common
24 stock (utility or otherwise) will sell at a price reflecting the discounted stream of
25 cash flows expected by investors. The objective is to estimate that discount rate.

1 Using certain simplifying assumptions (that I believe are generally
2 reasonable for utilities), the DCF model for dividend paying stocks can be
3 distilled down as follows:

4
$$K_e = (D_0/P_0) (1 + 0.5g) + g, \text{ where}$$

5 K_e = cost of equity;

6 D_0 = the current annualized dividend;

7 P_0 = stock price at the current time; and

8 g = the long-term annualized dividend growth rate.

9 As an example, assume a utility company has a current share price of
10 \$20.00, pays a current annualized dividend per share of \$1.00, and its dividend is
11 expected to grow over time by 5 percent per year. The DCF formula would
12 calculate the investor market rate of return to be:

13
$$(\$1.00 / \$20.00) (1.025) + 5.0\% = 10.13\%$$

14 This is referred to as the constant growth DCF model, because for
15 mathematical simplicity, it is assumed that the growth rate is constant for an
16 indefinitely long time period. While this constancy assumption may seem
17 restrictive in many cases, for traditional utilities (which tend to be more stable
18 than most unregulated companies) the assumption generally is reasonable,
19 particularly when applied to a group of companies.

20 Q. HOW HAVE YOU APPLIED THIS MODEL?

21 A. Strictly speaking, the model can be applied only to publicly-traded companies,
22 i.e., companies whose market prices (and therefore market valuations) are
23 transparently revealed. Consequently, the model cannot be applied to IPC, which
24 is a wholly-owned subsidiary of IdaCorp, and therefore, a market proxy is needed.

1 In theory, IdaCorp could serve as that market proxy, and I include IdaCorp as one
2 of my eleven West Region proxy companies.

3 In any case, I believe that an appropriately selected proxy group
4 (preferably one reasonable in size) is likely to be more reliable than a single
5 company study. This is because there is “noise” or fluctuations in stock price (or
6 other) data that cannot always be readily accounted for in a simple DCF study.
7 The use of an appropriate proxy group helps to allow such “data anomalies” to
8 cancel out in the averaging process.

9 For the same reason, I prefer to use market data that are relatively current
10 but averaged over a period of several months (i.e., six months rather than purely
11 relying upon “spot” market data). It is important to recall that this is not an
12 academic exercise but involves the setting of “permanent” utility rates that are
13 likely to be in effect for several years. The practice of averaging market data over
14 a period of several months can add stability to the results. Dr. Avera, by
15 comparison, appears to favor “spot” market data and has not indicated any plans
16 to provide an update.

17
18 **B. DCF Study Using the West Region Group of Electric Utility Companies**

19 Q. HOW DID YOU SELECT YOUR PROXY GROUP IN THIS CASE?

20 A. I have applied the DCF model to a group of eleven companies listed in the Value
21 Line Investment Survey as being West Region Electric Utilities. This is the same
22 general approach as taken by Dr. Avera in the 2004 rate case. He employed at
23 that time eight West Region companies, and seven of his eight are part of my
24 proxy group. I include all of the Value Line West Region electrics except (a) the
25 three California utilities (Edison International, Sempra Energy and PG&E), since

1 California is a restructured state; and (b) two companies that do not pay dividends
2 (Sierra Pacific Resources and El Paso). (Sierra just recently began to pay a very
3 small dividend after several years of no dividend payments.)

4 I provide a listing of these eleven companies on Exhibit No. 603, along
5 with certain risk indicators (i.e., Value Line Safety Rating, common equity ratio,
6 beta and financial strength rating). The "beta" measure is explained in detail later
7 in Section IV of my testimony. Two of the West Region companies, MDU
8 Resources and Pinnacle West, have the most favorable Value Line Safety Rating
9 ("1"), and for that reason I show the averages with and without those two
10 companies. The other nine companies have Safety Ratings of "2" or "3," with
11 IdaCorp being "3." The Safety Ratings range from "1" to "5". In general,
12 IdaCorp appears to have risk attributes generally similar to the nine-company
13 average, perhaps slightly greater in risk.

14 Q. HAVE EITHER YOU OR DR. AVERA PROPOSED A SPECIFIC RISK
15 ADJUSTMENT TO THE COST OF EQUITY BETWEEN THE PROXY
16 COMPANIES AND IPC'S UTILITY OPERATIONS?

17 A. No. Dr. Avera adopts a cost of equity range of 11.2 to 12.2 percent, and Mr.
18 Keen selects 11.5 percent which is close to the midpoint. While Mr. Keen
19 discusses risk issues, he does not quantify or propose a specific cost of equity
20 adjustment. I also do not propose a risk adjustment relative to my DCF results,
21 although my 10.25 percent recommendation is slightly above my DCF midpoint.

22 Q. HOW HAVE YOU APPLIED THE DCF MODEL TO THIS GROUP?

23 A. I have elected to use a six-month time period to measure the dividend yield
24 component (Do/Po) of the DCF formula. Using the Standard & Poor's Stock
25 Guide, I compiled the month-ending dividend yields for the six months ending

1 September 2007, the most recent data available to me as of this time. The
2 dividend yields are month-ending, and since the October 2007 edition of the
3 Stock Guide is not yet available, I have used Yahoo Finance (month-ending) as
4 the data source for my September 2007 yields (i.e., as of September 29, 2007).

5 I show these dividend yield data on page 3 of Exhibit No. 604 for each
6 proxy company, April through September 2007. Over this six-month period,
7 the group average dividend yields were highly stable ranging from a high of
8 3.88 percent in August to a low of 3.27 percent in April 2007, averaging
9 3.65 percent for the full six months. This indicates a mild upward trend over
10 this recent six-month period.

11 For DCF purposes and at this time, I am using a proxy group six-month
12 average dividend yield of 3.65 percent.

13 Q. IS 3.65 PERCENT YOUR FINAL DIVIDEND YIELD?

14 A. Not quite. Strictly speaking, the dividend yield used in the model should be the
15 value the investor expects over the next 12 months. Using the standard "half
16 year" growth rate adjustment technique, the DCF adjusted yield becomes 3.8
17 percent. This is based on assuming that half of a year of growth is 3.0 percent
18 (i.e., a full year growth is about 6.0 percent).

19 Q. DOES DR. AVERA EMPLOY THE SAME GROWTH RATE
20 ADJUSTMENT?

21 A. It appears that he uses a similar approach that would produce about the same end
22 result as my dividend adjustment. As best I can determine, he employs Value
23 Line's estimate of the per share dividend over the next 12 months. For a group of
24 companies, this would be roughly analogous to using the "0.5g" adjustment
25 factor.

1 Q. HOW HAVE YOU DEVELOPED YOUR GROWTH RATE
2 COMPONENT?

3 A. Unlike the dividend yield, the investor growth rate cannot be directly observed
4 but instead must be inferred through a review of available evidence. The growth
5 rate in question is the long-run dividend per share growth rate, but analysts
6 frequently use projected earnings growth as a proxy for (long-term) dividend
7 growth. This is because in the long-run earnings are the ultimate source of
8 dividend payments to shareholders, and this is likely to be particularly true for a
9 large group of companies.

10 One possible approach is to examine historical growth as a guide to
11 investor expected future growth, for example the recent five-year or ten-year
12 growth in earnings, dividends and book value per share. However, my experience
13 in recent years with utilities has been that these historic measures have been very
14 volatile and are not reliable as long-run prospective measures. This may be due in
15 part to extensive corporate restructuring in the energy industry. I note that
16 Dr. Avera also chooses to rely primarily on prospective rather than historical
17 growth measures. The DCF growth rate should be prospective, and one useful
18 source of information on prospective growth is the published projections of
19 earnings per share (typically five years) prepared by securities analysts.
20 Dr. Avera places primary weight on this information (along with earnings
21 retention growth), using earnings growth rates published by Value Line, IBES
22 and Reuters, and I agree that this type of evidence warrants substantial emphasis.

23 Q. PLEASE DESCRIBE YOUR EVIDENCE.

24 A. Exhibit No. 604, page 4 of 5, presents four well-known sources of projected
25 earnings growth rates. Three of these four sources -- First Call, Zacks and

1 Standard & Poors (S&P) -- provide averages from securities analyst surveys
2 conducted by these organizations (typically reporting the median value). The
3 fourth, Value Line, is that organization's own estimates. Value Line publishes its
4 own projections using annual average earnings share for a base period of 2004-
5 2006 to a forecast period of 2010-2012.

6 As this exhibit shows, the growth rates for individual companies vary
7 somewhat among the four sources, but the growth rate group averages are
8 generally similar. These group averages are 6.33 percent for S&P, 6.15 percent
9 for First Call, 6.62 percent for Zacks and 5.36 percent for Value Line. In this
10 case, I have calculated the average of these four sources, or about 6.2 percent, as
11 the best measure of expected growth, and a range of 5.5 to 6.5 percent.

12 Q. IS THERE ANY OTHER EVIDENCE THAT SHOULD BE
13 CONSIDERED?

14 A. Yes. There are a number of reasons why investor expectations of long-run growth
15 could differ from the limited, five-year earnings projections from securities
16 analysts. Consequently, while securities analyst estimates should be considered
17 and given substantial weight, these growth rates should be subject to a
18 reasonableness test and corroboration, to the extent feasible.

19 On Exhibit No. 604, page 5 of 5, I have compiled three other measures of
20 growth published by Value Line, i.e., growth rates of dividends and book value
21 per share and long-run retained earnings growth. (Retained earnings growth
22 reflects the growth over time one would expect from the reinvestment of retained
23 earnings, i.e., earnings not paid out as dividends.) As shown on this Exhibit, these
24 growth measures tend to be similar to or less than analyst growth projections.
25 Dividend growth averages 5.36 percent, book value growth averages 4.27 percent,

1 and earnings retention growth averages 4.72 percent. Notably, each of these
2 alternative measures of growth falls below the 5.5 to 6.5 percent range cited
3 above. This suggests that the growth rate range I have calculated for DCF
4 purposes may be conservatively high.

5 Q. WHAT IS YOUR DCF CONCLUSION?

6 A. I summarize my DCF analysis on page 1 of Exhibit No. 604. The adjusted
7 dividend yield for the six months ending September 2007 is 3.8 percent for this
8 group. Published projections would support a long-run growth rate in the range of
9 about 5.5 to 6.5 percent, as explained above. Summing the adjusted yield and
10 growth rate range produces a total return of 9.3 percent to 10.3 percent, and a
11 midpoint result of 9.8 percent.

12 Q. WHY DO YOU NOT INCLUDE AN ADJUSTMENT FOR FLOTATION
13 COSTS?

14 A. If a utility issues new common stock through public offering, it will likely incur
15 flotation expenses, principally underwriting fees. This is potentially a recoverable
16 expense, and one way of providing recovery is through a rate of return adder.
17 Dr. Avera proposes an adder of 0.2 percent, but it is not clear how he derives this
18 figure. He seems to suggest that his adjustment (which he claims is based on
19 3.6 percent of the issuance proceeds) is for historically-incurred flotation costs.
20 However, he presents no data on costs actually incurred historically by IPC.

21 The Company's response to DOE's first set of data requests, item 19,
22 indicates that the most recent public issuance was in 2004. The response to DOE
23 Set I, item 20 does not identify any plans for a public stock issuance. In any
24 event, Dr. Avera's 3.6 percent cost factor would imply a flotation adder of about
25 0.1 percent, not the 0.2 percent that he suggests. I obtain the 0.1 percent figure by

1 increasing the proxy group dividend yield (i.e., 3.65 percent) by 3.6 percent,
2 (3.65% x 3.6% = 0.13 percent). At this time, given the absence of any
3 information on a public stock issuance for the foreseeable future, I believe an
4 adjustment to the return on equity would not be appropriate. However, if the
5 Commission believes it is appropriate to include a flotation adder as part of the
6 return on equity award, I believe 0.1 percent would be sufficient.

7
8 **C. DCF Sensitivity**

9 Q. TWO OF YOUR WEST REGION ELECTRICS HAVE SAFETY
10 RATINGS MUCH BETTER THAN IDACORP. WOULD REMOVING
11 THOSE TWO COMPANIES FROM YOUR PROXY GROUP
12 SIGNIFICANTLY ALTER THE RESULTS?

13 A. I have tested for that effect by revising my DCF study removing the two West
14 Region electric companies (MDU Resources and Pinnacle West) rated "1" for
15 Safety. I summarize the revised DCF calculations on Exhibit No. 604, page 2,
16 with the modified proxy group averages shown on pages 3-5 of that exhibit.

17 Removal of the two companies increases the proxy group dividend yield
18 slightly from 3.65 to 3.68 percent. As shown on Exhibit No. 604, page 4,
19 removing the two companies also slightly increases the earnings growth rate
20 averages from 6.2 to 6.3 percent. For the analysis of this modified proxy group, a
21 reasonable growth rate range would be 5.8 to 6.3 percent. Using an adjusted yield
22 of 3.8 percent, the total return therefore becomes 9.6 to 10.3 percent, with a
23 midpoint of about 10.0 percent. Thus, the DCF sensitivity study is very similar to
24 my original DCF and fully supports the reasonableness of a return on equity of
25 10.25 percent.

1 D. Dr. Avera's DCF Estimates

2 Q. HOW DID DR. AVERA ESTIMATE THE COST OF EQUITY USING
3 THE DCF MODEL?

4 A. Dr. Avera employed an application of the standard DCF model to two proxy
5 groups of companies. The first analysis group uses a proxy group of 19 electric
6 utility companies in conjunction with four DCF growth measures. Three of the
7 growth measures are analyst projections of the growth in earnings per share
8 (published by IBES, Reuters and Value Line), and the fourth is Dr. Avera's own
9 calculations of growth from retained earnings (derived using Value Line data).
10 The DCF calculations employ market data as of March 30, 2007, and four sources
11 of growth produce DCF estimates for the 19-company group of 11.1 percent,
12 10.1 percent, 10.7 percent and 10.0 percent. The average of the four measures
13 produces an estimated investor return of about 10.4 percent, which approximates
14 the upper end of my own DCF range.

15 Dr. Avera's second DCF study does not employ utility companies at all,
16 but instead uses 61 unregulated companies. Not surprisingly, the non-utility study
17 produces dramatically higher DCF results -- 12.6 percent, 11.9 percent,
18 12.5 percent and 12.8 percent using the four growth rate measures, averaging
19 12.4 percent. This is a 20 percent cost of equity increase over his utility study
20 DCF results.

21 Q. ARE DR. AVERA'S DCF RESULTS REASONABLE?

22 A. His electric utility study corresponds to the upper end of my DCF results and in
23 that sense would seem to be a plausible estimate. However, his study of 61 non-
24 utility companies produces a completely unrealistic estimate of IPC's cost of
25 equity, and Dr. Avera has no convincing explanation for the enormous difference

1 in the results of his two studies. Since he ultimately recommends a range of 11.2
2 to 12.2 percent, it appears that he is putting considerable weight on his non-utility
3 DCF study. I believe that his non-utility study has little to do with IPC's actual
4 cost of equity and is not reasonable for use in this case.

5 I have concerns regarding the comparability of the 19 companies in his
6 electric utility proxy group as well. This is because a number of his proxy group
7 electric companies operate in competitively restructured states, and some of the
8 companies have substantial non-utility operations. The most appropriate risk
9 proxies for IPC would be electric utility companies that are fully regulated and
10 vertically-integrated, such as the eleven companies in my West Region proxy
11 group.

12 Q. WHICH UTILITY COMPANIES SHOULD BE ELIMINATED FROM
13 HIS PROXY GROUP?

14 A. Companies in Dr. Avera's group operating in restructured states or with
15 substantial unregulated operations would include:

- 16 • CenterPoint Energy (Texas)
- 17 • DPL, Inc. (Ohio)
- 18 • Energy East (New York, New England)
- 19 • Northeast Utilities (New England)
- 20 • PEPCO Holdings (Maryland, D.C., Delaware)
- 21 • PPL Corp. (Pennsylvania)
- 22 • Public Service Enterprise Group (New Jersey)
- 23 • PG&E Corp. (California)

24 I believe these companies are less useful and appropriate as proxies for
25 IPC than his other electric utility companies.

1 Q. HOW WOULD THE REMOVAL OF THE COMPANIES IN
2 RESTRUCTURED STATES AFFECT HIS DCF RESULTS?

3 A. On my Exhibit No. 605, I reproduce Dr. Avera's electric utility DCF calculations
4 using his four growth rate measures but removing the companies from the
5 restructured states and their non-utility operations. I have also excluded the West
6 Region companies in his group (i.e., IdaCorp, PNM, Xcel) since those three
7 companies are already included in my DCF study. As Exhibit No. 605 shows, a
8 DCF study of the fully regulated and vertically-integrated utility subset, provides
9 a return range of about 9.0 to 9.5 percent. This is modestly lower than or toward
10 the low end of my own DCF study results and is well below his 19-company
11 average of 10.4 percent. Please note that these are Dr. Avera's own DCF
12 calculations but for an appropriate subset of his utility proxy group.

13 Q. IS IT REASONABLE TO REMOVE THE COMPANIES FROM
14 RESTRUCTURED STATES?

15 A. Yes. I believe the integrated, fully-regulated companies are a more appropriate
16 risk proxy for IPC. In the 2004 case, the Commission recognized this distinction
17 noting that, "Idaho is not likely to have deregulation risks like those experienced
18 in other states". (Order, page 43, Case No. IPC-E-03-13) Clearly, those "other
19 states" would include California, the Northeast and Mid-Atlantic states, as
20 indicated above.

1 **IV. REVIEW OF DR. AVERA'S DCF, CAPM AND COMPARABLE EARNINGS**

2
3 **A. DCF Analysis**

4 Q. WHAT ARE YOUR OBJECTIONS TO DR. AVERA'S DCF
5 ANALYSIS?

6 A. Dr. Avera performs two DCF studies, one using a 19-company proxy group of
7 electric companies and a second that uses a large group of unregulated companies
8 operating in competitive markets. He obtains vastly different results for the two
9 proxy groups -- 10.4 percent for his electric company group and 12.4 percent for
10 the unregulated companies. In my opinion, the DCF study for the unregulated
11 companies has no value at all in determining the regulated fair return in this case
12 for IPC and therefore should be disregarded.

13 The DCF study for the electric group is more on point, and it actually
14 produces a result reasonably close to the 10.25 percent figure authorized by the
15 Commission in the 2004 rate case. However, as noted earlier, even this analysis
16 is improperly burdened by the inclusion of electric companies operating in
17 restructured states. Some of these companies have substantial non-regulated
18 operations (e.g., PPL Corporation). Removing the "restructured" companies
19 would reduce the group cost of equity to below 10 percent as I have shown on my
20 Exhibit 605.

21 Q. DOES THE COMMISSION RELY ON DCF EVIDENCE?

22 A. Yes, in conjunction with the comparables earning method. In particular, the
23 Commission's Order in Case No. IPC-E-03-13 (page 38) states:

24
25 The Commission has relied primarily on the discounted cash flow
26 method (DCF) and the comparable earnings method in previous
27 cases, and we do so again in this case.

1 That Order further observes that IPC is not burdened by “deregulation risks” such
2 as those experienced in other states. (*Id.*, page 43)

3
4 **B. CAPM Results**

5 Q. WHAT RESULTS DOES DR. AVERA OBTAIN USING THE CAPM?

6 A. He obtains a range of 11.5 percent to 12.8 percent, using two approaches. The
7 11.5 percent is a “historical” approach based on the realized stock market risk
8 premiums experienced (on average) over the last 80 years. The second method,
9 producing the 12.8 percent result, is based on a “prospective” market return
10 estimate for the overall stock market (or a large subset of the overall stock
11 market).

12 Q. PLEASE DESCRIBE THE CAPM APPROACH USED BY DR. AVERA.

13 A. The CAPM is a form of the “risk premium” approach and is based on modern
14 portfolio theory. According to this model, the cost of equity (K_e) is equal to the
15 yield on a risk-free asset plus an equity risk premium multiplied by a firm’s
16 “beta” statistic. “Beta” is a firm-specific risk measure which is computed as the
17 movements in a company’s stock price (or market return) relative to
18 contemporaneous movements in the broadly defined stock market. According to
19 CAPM theory, this measures the investment risk that cannot be reduced or
20 eliminated through asset diversification (i.e., holding a broad portfolio of assets).
21 The overall market, by definition, has a beta of 1.0, and a company with lower
22 than average investment risk (e.g., a utility company) normally would have a beta
23 below 1.0. The “risk premium” is defined as the expected return on the overall
24 stock market minus the yield or return on a risk-free asset.

1 The CAPM formula is:

2 $K_e = R_f + \beta (R_m - R_f)$, where

3 K_e = the firm's cost of equity;

4 R_m = the expected return on the overall market;

5 R_f = the yield on the risk free asset; and

6 β = the firm (or group of firms) risk measure.

7 Two of the three principal variables in the model are directly observable --
8 the yield on a risk-free asset (e.g., a Treasury security yield) and the beta. For
9 example, Value Line publishes estimated betas for each of the companies that it
10 covers. The greatest area of controversy, however, is in the measurement of the
11 expected stock market return (and therefore the risk premium), since that variable
12 cannot be directly observed.

13 While the beta itself also is technically "observable," different investor
14 service publications or sources provide differing estimates of betas depending on
15 the calculation methods that they use. These beta differences can have large
16 impacts on the CAPM cost of equity results. In this case, Dr. Avera employs
17 Value Line published betas, and I have used Value Line betas as well in past
18 cases. However, I note that other sources have very different utility betas, which
19 would yield lower results. I show an alternate source of betas, which I believe is
20 more plausible than the Value Line betas, in this subsection of my testimony.

21 Q. HOW HAS DR. AVERA APPLIED THIS MODEL?

22 A. Dr. Avera uses a long-term Treasury yield as the risk-free return (i.e.,
23 4.8 percent), and the average beta for his electric proxy group is 0.95. His
24 "historic" and "perspective" risk premium values are 7.1 percent and 8.5 percent,
25 respectively.

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These parameters yield the following CAPM results:

$$K_e = 4.8\% + 0.95 (7.1) = 11.55\%$$

$$K_e = 4.8 + 0.95 (8.5) = 12.88\%$$

Q. WHY DO YOU QUESTION THE VALUE LINE BETA ESTIMATES?

A. Dr. Avera employs a beta of 0.95, which implies that electric utilities generally (and IPC specifically) are nearly identical in risk to the stock market as a whole (i.e., largely unregulated companies). In fact, Value Line assigns IdaCorp (principally IPC) a beta of 1.05, implying that it is riskier than the stock market as a whole and has a cost of equity exceeding the stock market average. This clearly is unreasonable.

I compiled the table below which compares Value Line's betas for the West Region electrics with those recently published on the Yahoo Finance.com website. The Value Line average is 0.93, while the Yahoo Finance average is a far more realistic 0.74 -- correctly implying that electrics (and IPC) are significantly less risky than unregulated companies (i.e., the stock market as a whole).

**Alternative Beta Estimates for the
West Region Electrics**

| | <u>Value Line</u> | <u>Yahoo Finance</u> |
|------------------|-------------------|----------------------|
| Avista | 0.90 | 0.78 |
| Black Hills | 1.10 | 0.90 |
| Hawaiian | 0.75 | 0.31 |
| IdaCorp | 1.05 | 0.67 |
| MDU Resources | 1.00 | 1.02 |
| Pinnacle West | 0.95 | 1.06 |
| PNM Resources | 1.00 | 0.72 |
| Portland General | NA | 0.60 |
| Puget Energy | 0.85 | 0.67 |
| UniSource | 0.75 | NMF |
| Xcel | <u>0.90</u> | <u>0.63</u> |
| Average | 0.93 | 0.74 |

Source: *Value Line Investment Survey*, August 30, 2007, YahooFinance.com, September 2007.

- 1 Q. DO YOU FIND THE 7.1 TO 8.5 PERCENT RISK PREMIUM TO BE
2 REASONABLE?
- 3 A. No. The "historical" 7.1 percent is a 1926-2006 stock market arithmetic average
4 risk premium, based on after-the-fact market returns, compiled by Ibbotson
5 Associates. However, Dr. Avera overlooks a key flaw or limitation in that
6 estimate (as a measure of today's risk premium) that Dr. Ibbotson himself has
7 discovered. His recent research has concluded that the 7.1 percent is biased
8 upward by a rising price/earnings ratio over the historic period, and the
9 continuation of that trend would be inconsistent with standard financial theory.
10 He has corrected the historic data removing this upward bias, obtaining a
11 corrected historic (arithmetic average) risk premium of 5.9 percent. (Roger

1 G. Ibbotson and Peng Chen, "Stock Market Returns in the Long Run:
2 Participating in the Real Economy", *Financial Analyst Journal*, 2003.)

3 The 8.5 percent risk premium itself is based on Dr. Avera's very
4 questionable assumption that earnings on unregulated companies (i.e., the
5 dividend paying stock in the S&P 500) will increase by 11.2 percent per year.
6 I believe that this is excessively optimistic as an overall average expectation for
7 the long-term rate of growth in corporate earnings. For example, the Value Line
8 *Selection and Opinion*, page 4559, projects the growth rate in Corporate
9 Economic Profits for 2007 to 2011 to range from 6.6 to 8.0 percent per year. *Blue*
10 *Chip Economic Indicators* (March 10, 2007), a survey of major forecasts,
11 publishes a "consensus" forecast for U. S. pre-tax corporate profits (current \$)
12 grow by 5.1 percent annually for 2009-2013 and 5.4 percent annually for 2014-
13 2018. In light of these major forecasts, Dr. Avera's corporate forecast growth rate
14 of 11.2 percent (and resulting 8.5 percent risk premium) makes no sense and is
15 implausibly high.

16 Q. ARE YOU AWARE OF ANY OTHER EVIDENCE THAT WOULD
17 CHALLENGE THE 7.1 TO 8.5 PERCENT RISK PREMIUM RANGE?

18 A. Yes. The prominent textbook by Brealy, Myers and Allen (*Principles of*
19 *Corporate Finance*, 8th Edition, page 152) cites to survey data estimates of the
20 equity risk premiums. A 2001 Yale University survey study of financial
21 economists finds a 5.5 percent risk premium, and a 2003 Duke University study
22 of corporate Chief Financial Officers ("CFOs") obtains a 3.8 percent risk
23 premium. While survey estimates are not necessarily precise measures, this is
24 "real world" information that challenges the reasonableness of Dr. Avera's clearly
25 overstated equity risk premium range of 7.1 to 8.5 percent.

1 Q. ARE YOU SPONSORING A CAPM STUDY?

2 A. No, I am not sponsoring such a study as a basis for establishing IPC's cost of
3 equity in this case for the reasons discussed above. It is also apparent that the
4 Commission has concerns about this method's usefulness and in particular "the
5 measurement and proper use of Beta". (Order No. 29505, page 38, May 25,
6 2004) However, as a comparison and check on Dr. Avera's CAPM, I present a
7 CAPM calculation using: a risk-free rate of 4.8 percent (the same as used by Dr.
8 Avera), a beta of 0.84 (the average of the Value Line and the Yahoo Finance
9 betas) and a 6.0 percent risk premium.

$$K_e = 4.8 + 0.84 (6.0) = 9.84 \text{ percent}$$

13 While I do not advocate the use in this case of the CAPM method, I
14 believe the 9.84 percent result shown above for IPC is much more realistic than
15 Dr. Avera's 11.5 to 12.8 percent results.

16

17 C. Comparable Earnings

18 Q. WHAT RESULTS DID DR. AVERA OBTAIN FROM HIS
19 COMPARABLE EARNINGS STUDY?

20 A. Dr. Avera focused on the Value Line projections of earned return on equity for his
21 electric utility proxy group (10.6 percent). He also cites to the Value Line
22 estimated return on equity of 11.0 percent for 2007 and 11.5 percent for the
23 electric industry as a whole for the three to five-year forecast horizon. Based on
24 this information, he derives a final comparable earnings estimate of 11.0 percent.
25 (Avera, page 56 and his Exhibit 608)

26 Q. DOES HIS COMPARABLE EARNINGS ANALYSIS PROVIDE A
27 MARKET COST OF EQUITY ESTIMATE?

1 A. No, and he does not appear to claim that it does. Rather, these are one
2 organization's (i.e., Value Line's) estimates of the accounting returns on book
3 equity that electric companies might earn. It does not measure either the return
4 requirements or expectations for financial markets. One key reason why that is so
5 is because the electric utility companies have stock prices selling at a premium-to-
6 book value, a fact that Dr. Avera does not mention.

7 Q. WHY DOES THE MARKET-TO-BOOK RATIO MATTER?

8 A. Consider an electric utility with earnings per share of \$2.20 and a book value of
9 \$20. This would equal Dr. Avera's 11.0 percent accounting return on equity.
10 However, if the stock price is \$30, then the investor is really earning $\$2.2 / \$30 =$
11 7.3 percent on the market value of his investment. Put another way, the investor
12 is willing to pay \$30 per share for the stock and receive \$2.20 in current earnings.
13 The fact that the market value of the stock significantly exceeds book value
14 renders the usefulness of Dr. Avera's comparable earnings study highly
15 questionable.

16 Q. DO YOU HAVE ANY ALTERNATIVE CALCULATIONS OF
17 COMPARABLE EARNINGS?

18 A. Yes. As a comparison, I have compiled the historical (i.e., 2005 - 2007) and
19 projected (2010 - 2012) earned returns on equity, as published by Value Line, on
20 Exhibit No. 606 for my West Region electric group and for Dr. Avera's electric
21 group, i.e., the vertically-integrated subset. (Please note that 2007 is partly actual
22 and partly projected.)

23 As shown on page 1, the West Region earned return on equity averages
24 about 9.0 percent for both the historic and projected period. For Dr. Avera's
25 vertically-integrated companies, the spread of results is much wider. (Page 2 of

1 Exhibit No. 606) During the historical period, the group average return on equity
2 is about 10 percent but increases to 10.8 percent for the projected period.
3 However, the averages are heavily influenced by one unusually profitable
4 company -- Dominion Resources. Absent Dominion, the projected average return
5 for 2010-2012 declines to 9.8 percent.

6 If the two proxy groups on pages 1 and 2 of Exhibit No. 606 are
7 combined, the average earned returns on equity would generally fall in the 9 to
8 10 percent range.

9 Q. WHAT DO YOU CONCLUDE?

10 A. While not a market cost of equity method, the comparable earnings analysis
11 results are roughly consistent with my DCF evidence and help to support a return
12 on equity award in this case not to exceed 10.25 percent.

13

1 **V. CONCLUSIONS ON FAIR RATE OF RETURN**

2 Q. PLEASE SUMMARIZE THE CONCLUSIONS THAT YOU HAVE
3 REACHED CONCERNING THE COMPANY'S RATE OF RETURN
4 REQUEST.

5 A. IPC in this case is seeking an overall rate of return of 8.56 percent, based on a
6 projected year-end 2007 capital structure and embedded cost of debt and inclusive
7 of a return on common equity of 11.5 percent. The requested return on equity is
8 the approximate midpoint of Dr. Avera's study range of 11.2 to 12.2 percent.
9 IPC's 11.5 percent return on equity request is a very large increase over the 10.25
10 percent return on equity awarded by the Commission in the 2004 rate case, an
11 award accompanied by a 46 percent common equity ratio.

12 Subject to possible updating, I find acceptable the proposed capital
13 structure and embedded cost of debt. However, I do not agree with IPC's request
14 and supporting evidence to increase the return on common equity from 10.25
15 percent awarded in 2004 to 11.5 percent – a 12 percent increase. While capital
16 cost conditions were favorable in 2004, the utility cost of capital remains low
17 today. IPC is a financially sound, credit worthy utility with several favorable
18 business risk attributes. Most of the evidence presented by Dr. Avera
19 significantly overstates the IPC cost of equity and fair return.

20 Q. PLEASE SUMMARIZE YOUR SPECIFIC DISAGREEMENTS WITH
21 DR. AVERA.

22 A. Dr. Avera presents three types of studies: DCF, CAPM and comparable earnings.
23 My only significant disagreement with his DCF evidence is with his proxy
24 company selection. His non-utility DCF study obtained 12.4 percent, but clearly
25 non utilities from other industries are not proper risk or business proxies for IPC's

1 Idaho monopoly utility operations. These non-regulated companies from other
2 industries are fundamentally different from IPC. His "utility" DCF study yields a
3 more reasonable 10.4 percent, but even that study is impaired by its inclusion of
4 several "restructured" companies. Some of those companies have risk profiles
5 and operating environments much different than IPC. His subset of vertically-
6 integrated utilities yields DCF results less than 10.0 percent.

7 The CAPM significantly overstates the cost of equity by assuming a stock
8 market risk premium in the 7 to 8 percent range, when a more realistic estimate is
9 6 percent or less, and he selects a "beta" value of 0.95. The latter figure is
10 tantamount to assuming that IPC's risks as a regulated utility approximate that of
11 the market as a whole. In addition to these shortcomings, the Commission has
12 expressed concerns over the reliability and applicability to IPC of the CAPM.

13 Finally, Dr. Avera obtains an 11.0 percent result based on Value Line
14 projections of accounting returns on common equity for his utility proxy group
15 (and the industry as a whole). This evidence is problematic and overstated for the
16 reason stated previously -- the utility group includes many companies that operate
17 in an unregulated environment in restructured states. Moreover, his calculations
18 ignore the fact that these companies sell at a large premium to book value.

19 Q. PLEASE SUMMARIZE YOUR OWN EVIDENCE ON COST OF
20 CAPITAL FOR IPC.

21 A. I recommend an overall return of 7.93 percent, which includes a 10.25 percent
22 cost of capital. I rely primarily on a DCF study of a group of West Region
23 electric utilities (excluding California) obtaining a range of 9.3 to 10.3 percent (or
24 9.6 to 10.3 percent if two companies are excluded). Consistent with Dr. Avera, I
25 have used the standard, constant growth DCF model, recent stock market data and

1 securities analyst projections of earnings growth. My nine-company proxy group
2 is reasonably comparable to IPC since all companies are vertically integrated
3 electrics primarily operating under standard regulation. This is similar to the
4 proxy group previously used by Dr. Avera in the 2004 IPC rate case.

5 As a check and to respond to Dr. Avera, I have employed the comparable
6 earnings method, using my proxy group and the vertically-integrated portion of
7 Dr. Avera's proxy group. For these companies, the historical and projected
8 earned returns on equity display averages in the range of about 9.0 to 10.0
9 percent, with the exception of one unusual company. The comparable earnings
10 evidence helps to support the reasonableness of my 10.25 percent
11 recommendation.

12 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY

13 A. Yes, it does.

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STATE OF IDAHO
BEFORE THE
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)

EXHIBITS ACCOMPANYING THE
DIRECT TESTIMONY OF
MATTHEW I. KAHAL

ON BEHALF OF THE
U.S. DEPARTMENT OF ENERGY

DECEMBER 10, 2007

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 20904

IDAHO POWER COMPANY

Rate of Return Summary

(Provisional Estimate for the Period Ending December 31, 2007))

| <u>Capital Type</u> | <u>Percent of Total¹</u> | <u>Cost Rate¹</u> | <u>Weighted Cost</u> |
|---------------------|---|------------------------------|----------------------|
| Long-Term Debt | 49.74% | 5.59% | 2.78% |
| Preferred Stock | 0.00 | 0.00 | 0.00 |
| Common Equity | <u>50.26</u> | <u>10.25²</u> | <u>5.15</u> |
| Total | 100.00% | -- | 7.93% |

¹ IPC Exhibit 10 of witness Keen.

² Schedule MIK-4, page 1 of 4.

IDAHO POWER COMPANY

Trends in Capital Costs

| | <u>Annualized Inflation (CPI)</u> | <u>10-Year Treasury Yield</u> | <u>3-Month Treasury Yield</u> | <u>Single A Utility Yield</u> |
|------|---------------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| 1992 | 3.0% | 7.0% | 3.5% | 8.7% |
| 1993 | 3.0 | 5.9 | 3.0 | 7.6 |
| 1994 | 2.6 | 7.1 | 4.3 | 8.3 |
| 1995 | 2.8 | 6.6 | 5.5 | 7.9 |
| 1996 | 3.0 | 6.4 | 5.0 | 7.8 |
| 1997 | 2.3 | 6.4 | 5.1 | 7.6 |
| 1998 | 1.6 | 5.3 | 4.8 | 7.0 |
| 1999 | 2.2 | 5.7 | 4.7 | 7.6 |
| 2000 | 3.4 | 6.0 | 5.9 | 8.2 |
| 2001 | 2.9 | 5.0 | 3.5 | 7.8 |
| 2002 | 1.6 | 4.6 | 1.6 | 7.4 |
| 2003 | 1.9 | 4.1 | 1.0 | 6.6 |
| 2004 | 2.7 | 4.3 | 1.4 | 6.2 |
| 2005 | 3.4 | 4.3 | 3.0 | 5.6 |
| 2006 | 2.5 | 4.8 | 4.8 | 6.1 |

IDAHO POWER COMPANY

Trends in Capital Costs (Continued)

| | <u>Annualized Inflation (CPI)</u> | <u>10-Year Treasury Yield</u> | <u>3-Month Treasury Yield</u> | <u>Single A Utility Yield</u> |
|-------------|---------------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| <u>2002</u> | | | | |
| January | 1.1% | 5.0% | 1.7% | 7.7% |
| February | 1.1 | 4.9 | 1.7 | 7.5 |
| March | 1.5 | 5.3 | 1.8 | 7.8 |
| April | 1.6 | 5.2 | 1.7 | 7.6 |
| May | 1.2 | 5.2 | 1.7 | 7.5 |
| June | 1.1 | 4.9 | 1.7 | 7.4 |
| July | 1.5 | 4.7 | 1.7 | 7.3 |
| August | 1.8 | 4.3 | 1.6 | 7.2 |
| September | 1.5 | 3.9 | 1.6 | 7.1 |
| October | 2.0 | 3.9 | 1.6 | 7.2 |
| November | 2.2 | 4.1 | 1.3 | 7.1 |
| December | 2.4 | 4.0 | 1.2 | 7.1 |
| <u>2003</u> | | | | |
| January | 2.6% | 4.1% | 1.2% | 7.1% |
| February | 3.0 | 3.9 | 1.2 | 6.9 |
| March | 3.0 | 3.8 | 1.1 | 6.8 |
| April | 2.1 | 4.0 | 1.1 | 6.6 |
| May | 2.1 | 3.6 | 1.1 | 6.4 |
| June | 2.1 | 3.7 | 0.9 | 6.2 |
| July | 2.1 | 4.0 | 0.9 | 6.6 |
| August | 2.2 | 4.5 | 1.0 | 6.8 |
| September | 2.3 | 4.3 | 1.0 | 6.6 |
| October | 2.0 | 4.3 | 0.9 | 6.4 |
| November | 1.8 | 4.3 | 1.0 | 6.4 |
| December | 1.8 | 4.3 | 0.9 | 6.3 |
| <u>2004</u> | | | | |
| January | 1.9% | 4.2% | 0.9% | 6.2% |
| February | 1.7 | 4.1 | 0.9 | 6.2 |
| March | 1.7 | 3.8 | 0.9 | 6.0 |
| April | 2.3 | 4.4 | 0.9 | 6.4 |
| May | 3.1 | 4.7 | 1.0 | 6.6 |
| June | 3.3 | 4.7 | 1.3 | 6.5 |
| July | 3.0 | 4.5 | 1.4 | 6.3 |
| August | 2.7 | 4.3 | 1.5 | 6.1 |
| September | 2.5 | 4.1 | 1.6 | 6.0 |
| October | 3.2 | 4.1 | 1.8 | 5.9 |
| November | 3.5 | 4.2 | 2.1 | 6.0 |
| December | 3.3 | 4.2 | 2.2 | 5.9 |

IDAHO POWER COMPANY

Trends in Capital Costs (Continued)

| | <u>Annualized Inflation (CPI)</u> | <u>10-Year Treasury Yield</u> | <u>3-Month Treasury Yield</u> | <u>Single A Utility Yield</u> |
|-------------|---|-----------------------------------|-----------------------------------|-----------------------------------|
| <u>2005</u> | | | | |
| January | 3.0% | 4.2% | 2.4% | 5.8% |
| February | 3.0 | 4.2 | 2.6 | 5.6 |
| March | 3.1 | 4.5 | 2.8 | 5.8 |
| April | 3.5 | 4.3 | 2.8 | 5.6 |
| May | 2.8 | 4.1 | 2.9 | 5.5 |
| June | 2.5 | 4.0 | 3.0 | 5.4 |
| July | 3.2 | 4.2 | 3.3 | 5.5 |
| August | 3.6 | 4.3 | 3.5 | 5.5 |
| September | 4.7 | 4.2 | 3.5 | 5.5 |
| October | 4.3 | 4.5 | 3.8 | 5.8 |
| November | 3.5 | 4.5 | 4.0 | 5.9 |
| December | 3.4 | 4.5 | 4.0 | 5.8 |
| <u>2006</u> | | | | |
| January | 4.0% | 4.4% | 4.3% | 5.8% |
| February | 3.6 | 4.6 | 4.5 | 5.8 |
| March | 3.4 | 4.7 | 4.6 | 6.0 |
| April | 3.5 | 5.0 | 4.7 | 6.3 |
| May | 4.2 | 5.1 | 4.8 | 6.4 |
| June | 4.3 | 5.1 | 4.9 | 6.4 |
| July | 4.1 | 5.1 | 5.1 | 6.4 |
| August | 3.8 | 4.9 | 5.1 | 6.2 |
| September | 2.1 | 4.7 | 4.9 | 6.0 |
| October | 3.5 | 4.7 | 5.1 | 6.0 |
| November | 2.5 | 4.6 | 5.1 | 5.8 |
| December | 2.5 | 4.6 | 5.0 | 5.8 |

IDAHO POWER COMPANY

Trends in Capital Costs (Continued)

| | <u>Annualized Inflation (CPI)</u> | <u>10-Year Treasury</u> | <u>3-Month Treasury</u> | <u>Single A Utility Yield</u> |
|-------------|---------------------------------------|-----------------------------|-----------------------------|-----------------------------------|
| <u>2007</u> | | | | |
| January | 2.1% | 4.8% | 5.1% | 6.0% |
| February | 2.4 | 4.7 | 5.2 | 5.9 |
| March | 2.8 | 4.6 | 5.1 | 5.9 |
| April | 2.6 | 4.7 | 5.0 | 6.0 |
| May | 2.7 | 4.8 | 5.0 | 6.0 |
| June | 2.7 | 5.1 | 5.0 | 6.3 |
| July | 2.4 | 5.0 | 5.0 | 6.3 |
| August | 2.0 | 4.7 | 4.3 | 6.2 |
| September | -- | 4.5 | 4.0 | -- |

Source: Economic Report of the President, Mergent's Bond
Record, Federal Reserve Statistical Release, Consumer Price Index Summary.

IDAHO POWER COMPANY

Value Line Risk Indicators for the Primary Group Proxy Companies

| <u>Company</u> | <u>Safety Rating</u> | <u>Beta</u> | <u>2006 Common Equity Ratio*</u> | <u>Financial Strength</u> |
|---------------------------------------|--------------------------|-------------|--------------------------------------|-------------------------------|
| Avista Corp. | 3 | 0.90 | 46.3% | B+ |
| Black Hills Corp | 3 | 1.10 | 55.7 | B+ |
| Hawaii Electric Ind. | 2 | 0.75 | 48.6 | A |
| IDACORP | 3 | 1.05 | 54.8 | B+ |
| MDU Resources Group | 1 | 1.00 | 64.5 | A+ |
| PNM Resources | 2 | 0.95 | 48.8 | B++ |
| Pinnacle West | 1 | 1.00 | 51.6 | A |
| Portland General | 2 | NA | 56.6 | B++ |
| Puget Energy | 3 | 0.85 | 44.4 | B+ |
| UniSource | 3 | 0.75 | 27.1 | C++ |
| Xcel Energy | <u>2</u> | <u>0.90</u> | <u>47.0</u> | <u>B++</u> |
| Average | 2.3 | 0.93 | 49.6% | -- |
| Average (w/o MDU/Pinnacle) | 2.6 | 0.91 | 47.7% | -- |

Source: Value Line Investment Survey, August 10, 2007.

* Please note that the common equity ratios published by Value Line exclude short-term debt and the current portion of long-term debt.

IDAHO POWER COMPANY

DCF Summary for Full Western Proxy Group

| | |
|---|---------------|
| (1) Dividend Yield (April-September 2007) | 3.65% |
| (2) Adjusted Yield (3.65 x 1.03) | 3.8 |
| (3) DCF Growth Rate | 5.5 - 6.5 |
| (4) Flotation Adjustment | 0.00 |
| (5) Total Return | 9.3 - 10.3 |
| (6) Midpoint | 9.8 |
| Recommendation | 10.25% |

-
- (1) DCF Model: $K_e = (D_0/P_0) (1 + 0.5g) + g$, where
 K_e = cost of equity
 D_0 = current annualized dividend
 P_0 = current share price
 g = long-term dividend growth rate

IDAHO POWER COMPANY

DCF Summary for Full Western Proxy Group Excluding Companies with Safety Rating of "1"

| | |
|---|---------------|
| (1) Dividend Yield (April-September 2007) | 3.68% |
| (2) Adjusted Yield (3.68 x 1.03) | 3.8 |
| (3) DCF Growth Rate | 5.8 - 6.5 |
| (4) Flotation Adjustment | 0.00 |
| (5) Total Return | 9.6 - 10.3 |
| (6) Midpoint | 10.0 |
| Recommendation | 10.25% |

-
- (1) DCF Model: $K_e = (D_0/P_0) (1 + 0.5g) + g$, where
Ke = cost of equity
Do = current annualized dividend
Po = current share price
g = long-term dividend growth rate

IDAHO POWER COMPANY

Proxy Group Dividend Yields
April - September 2007

| <u>Company</u> | <u>April</u> | <u>May</u> | <u>June</u> | <u>July</u> | <u>August</u> | <u>September</u> | <u>Average</u> |
|---------------------------------------|--------------|--------------|--------------|--------------|---------------|------------------|----------------|
| (1) Avista | 2.5% | 2.6% | 2.8% | 3.0% | 3.1% | 3.0% | 2.83% |
| (2) Black Hills | 3.4 | 3.3 | 3.4 | 3.6 | 3.3 | 3.2 | 3.37 |
| (3) Hawaiian | 4.7 | 5.1 | 5.2 | 5.4 | 5.9 | 5.8 | 5.35 |
| (4) IdaCorp | 3.5 | 3.6 | 3.7 | 3.9 | 3.7 | 3.6 | 3.67 |
| (5) MDU | 1.8 | 1.8 | 1.9 | 2.0 | 2.1 | 2.1 | 1.95 |
| (6) PNM | 2.8 | 3.1 | 3.3 | 3.6 | 4.0 | 4.0 | 3.47 |
| (7) Pinnacle West | 4.3 | 4.5 | 5.3 | 5.6 | 5.3 | 5.3 | 5.05 |
| (8) Portland Gen. | 3.1 | 3.2 | 3.4 | 3.5 | 3.5 | 3.3 | 3.33 |
| (9) Puget Energy | 3.9 | 4.0 | 4.1 | 4.3 | 4.3 | 4.1 | 4.12 |
| (10) UniSource | 2.3 | 2.5 | 2.7 | 3.0 | 3.0 | 2.9 | 2.73 |
| (11) Xcel | <u>3.7</u> | <u>4.0</u> | <u>4.5</u> | <u>4.5</u> | <u>4.5</u> | <u>4.2</u> | <u>4.23</u> |
| Average | 3.27% | 3.42% | 3.66% | 3.85% | 3.88% | 3.77% | 3.65% |
| Average (w/o MDU/Pinnacle) | 3.32% | 3.49% | 3.68% | 3.87% | 3.92% | 3.79% | 3.68% |

Source: Standard & Poors, Stock Guide (May-September 2007). September figures are from Yahoo Finance, September 28, 2007.

IDAHO POWER COMPANY

Analyst Projected Growth Rates Five-Year Earnings Per Share

| | <u>Company</u> | <u>S&P</u> | <u>Zacks</u> | <u>First Call</u> | <u>Value Line</u> | <u>Average</u> |
|------|---------------------------------------|----------------|--------------|-------------------|-------------------|----------------|
| (1) | Avista | 6% | 4.5% | 4.33% | 9.0% | 5.96% |
| (2) | Black Hills | 7 | 6.5 | 6.67 | 5.5 | 6.42 |
| (3) | Hawaiian | 5 | 4.9 | 3.10 | 1.5 | 3.63 |
| (4) | IdaCorp | 5 | 6.0 | 5.67 | 2.0 | 4.67 |
| (5) | MDU | 8 | 7.7 | 7.35 | 5.0 | 7.01 |
| (6) | PNM | 11 | 8.8 | 10.47 | 4.5 | 8.69 |
| (7) | Pinnacle West | 4 | 6.7 | 5.73 | 1.5 | 4.48 |
| (8) | Portland | NA | 6.5 | 6.5 | 14.5 | 9.17 |
| (9) | Puget Energy | 5 | 5.5 | 5.32 | 6.0 | 5.46 |
| (10) | UniSource | NA | 10.0 | NA | 4.0 | 7.00 |
| (11) | Xcel | <u>6</u> | <u>4.8</u> | <u>6.33</u> | <u>5.5</u> | <u>5.66</u> |
| | Average | 6.33% | 6.62% | 6.15% | 5.36% | 6.20% |
| | Average (w/o MDU/Pinnacle) | 6.43% | 6.50% | 6.05% | 5.83% | 6.30% |

Sources: S&P Earnings Guide, MSN Money.com (Zacks), Yahoo Finance.com (First Call), Value Line Investment Survey, August 10, 2007.

IDAHO POWER COMPANY

Value Line Growth Rate Indicators Five-Year Projections

| <u>Company</u> | <u>Dividends Per Share</u> | <u>Book Value Per Share</u> | <u>2010-2012 Retained to Common Equity</u> |
|---|--------------------------------|---------------------------------|--|
| (1) Avista | 12.5% | 4.0% | 3.0% |
| (2) Black Hills | 3.0 | 5.0 | 4.5 |
| (3) Hawaiian | 0.0 | (0.5) | 2.5 |
| (4) Idaho | 0.0 | 4.0 | 3.5 |
| (5) MDU | 6.5 | 10.5 | 7.0 |
| (6) PNM | 6.0 | 5.5 | 3.5 |
| (7) Pinnacle West | 3.0 | 1.5 | 1.5 |
| (8) Portland | 13.5 | 5.0 | 4.0 |
| (9) Puget Energy | 3.0 | 4.0 | 4.0 |
| (10) UniSource | 7.0 | 4.0 | 3.5 |
| (11) Xcel | <u>4.5</u> | <u>4.0</u> | <u>4.0</u> |
| Average | 5.36% | 4.27% | 3.72% |
| Average (w/o MDU/Pinnacle) | 5.5% | 3.89% | 3.61% |

Sources: Value Line Investment Survey, August 10, 2007.

IDAHO POWER COMPANY

Dr. Avera's DCF Estimates Based on Alternative Growth Rate Sources
(Integrated Utility Subsample)

| <u>Company</u> | <u>IBES</u> | <u>V.L.</u> | <u>Reuters</u> | <u>br x sv</u> | <u>Average</u> | <u>Restricted Average*</u> |
|----------------------|-------------|-------------|----------------|----------------|----------------|--------------------------------|
| (1) Alliant | 8.8% | 7.8% | 8.5% | 7.1% | 8.1% | 8.4% |
| (2) American Elec. | 7.4 | 10.4 | 8.2 | 9.5 | 8.9 | 8.9 |
| (3) Dominion | 11.3 | 18.3 | 12.5 | 14.4 | 14.1 | 12.7 |
| (4) DTE Energy | 10.5 | 8.5 | 10.3 | 7.0 | 9.1 | 9.8 |
| (5) Integrys | 9.8 | 5.8 | 9.2 | 10.3 | 8.8 | 9.8 |
| (6) NiSource | 6.8 | 9.3 | 7.2 | 7.3 | 7.7 | 7.9 |
| (7) Progress Energy | 8.8 | 4.8 | 9.4 | 7.0 | 7.5 | 9.1 |
| (8) Wisconsin Energy | <u>11.1</u> | <u>8.6</u> | <u>9.9</u> | <u>9.0</u> | <u>9.7</u> | <u>9.7</u> |
| Average | 9.3% | 9.2% | 9.4% | 9.0% | 9.2% | 9.5% |

Source: Dr. Avera Exhibit No. 2. Excludes utilities from restructured states and Western utilities (i.e., IdaCorp, PNM Resources and Xcel)

*This is the average DCF estimate after removal of some unusually low DCF figures.

IDAHO POWER COMPANY

Historical/Projected Earned Return on Equity West Region Electric Utility Companies

| | <u>Company</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2010-2012</u> |
|------|----------------|-------------|-------------|-------------|------------------|
| (1) | Avista | 5.9% | 8.0% | 5.5% | 8.0% |
| (2) | Black Hills | 9.5 | 9.4 | 9.0 | 9.5 |
| (3) | Hawaiian | 9.7 | 9.9 | 7.5 | 11.0 |
| (4) | IdahoCorp | 6.2 | 8.9 | 7.5 | 7.0 |
| (5) | MDU | 14.6 | 14.8 | 12.5 | 11.0 |
| (6) | PNM | 8.2 | 7.2 | 8.0 | 7.5 |
| (7) | Pinnacle West | 6.5 | 9.2 | 7.5 | 8.0 |
| (8) | Portland | 5.3 | 5.8 | 11.0 | 8.5 |
| (9) | Puget Energy | 7.2 | 7.9 | 8.5 | 9.0 |
| (10) | UniSource | 7.5 | 10.6 | 8.0 | 8.5 |
| (11) | Xcel | <u>9.2</u> | <u>9.7</u> | <u>9.5</u> | <u>10.0</u> |
| | Average | 8.2% | 9.2% | 8.6% | 9.0% |

Sources: Value Line Investment Survey, August 10, 2007.

IDAHO POWER COMPANY

Historical/Projected Earned Return on Equity Eastern and Central Integrated Utility Companies

| | <u>Company</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2010-2012</u> |
|-----|-----------------------------------|--------------|-------------|--------------|------------------|
| (1) | Alliant | 13.1% | 9.1% | 11.5% | 10.0% |
| (2) | American Electric | 11.3 | 12.0 | 11.5 | 12.5 |
| (3) | Dominion | 9.9 | 13.1 | 17.5 | 17.5 |
| (4) | DTE | 10.5 | 7.5 | 11.5 | 9.5 |
| (5) | Integrus | 11.8 | 9.7 | 6.5 | 8.5 |
| (6) | NiSource | 6.0 | 6.3 | 7.0 | 7.0 |
| (7) | Progress | 9.0 | 6.1 | 9.0 | 9.5 |
| (8) | Wisconsin | <u>11.3</u> | <u>10.8</u> | <u>10.5</u> | <u>11.5</u> |
| | Average | 10.4% | 9.3% | 10.6% | 10.8% |
| | Average (w/o Dominion) | 10.4% | 8.8% | 9.6% | 9.8% |

Sources: Value Line Investment Survey, August 31 and September 28, 2007.

July 10, 2007

Ms. Jean Jewell
Commission Secretary
Idaho Public Utilities Commission
P.O. Box 83720
Boise, ID 83720-0074

RE: Case No. IPC-E-07-8

Dear Ms. Jewell:

Enclosed please find the original and seven (7) copies of the PETITION OF THE UNITED STATES DEPARTMENT OF ENERGY FOR LEAVE TO INTERVENE in the above-captioned proceeding. Also enclosed is an additional copy of the Petition for Leave to Intervene that I ask be date stamped and returned in the enclosed stamped envelope.

If you have any questions concerning this filing, please do not hesitate to contact me at (202) 586-3409.

Arthur Perry Bruder
Attorney-Advisor
United States Department of Energy
Office of the General Counsel
1000 Independence Avenue SW
Washington, DC 20585
Telephone: (202) 586-3409
Facsimile: (202) 586-7479

CERTIFICATE OF SERVICE - CASE NO. IPC-E-07-8

I hereby certify that I have this 10th day of December, 2007, served or caused to be served a true and correct copy of the attached DIRECT TESTIMONY OF MATTHEW I. KAHAL ON BEHALF OF THE UNITED STATES DEPARTMENT OF ENERGY upon each of the parties listed below, by placing the same in the U.S. Mail, postage prepaid.

Barton L. Kline
Lisa D. Nordstrom
Idaho Power Company
1221 W. Idaho St. (83702)
P.O. Box 70
Boise, ID 83707-0070

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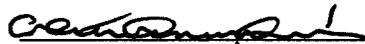
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