BEFORE THE

IDAHO PUBLIC UTILITIES COMMISSION

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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 IN THE STATE OF IDAHO.	)))))))))	CASE NO. IPC-E-07-8

DIRECT TESTIMONY OF RANDY LOBB

IDAHO PUBLIC UTILITIES COMMISSION

DECEMBER 10, 2007

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

A. My name is Randy Lobb and my business address is 472 West Washington Street, Boise, Idaho.

Q. By whom are you employed?

A. I am employed by the Idaho Public Utilities Commission as Utilities Division Administrator.

Q. What is your educational and professional background?

A. I received a Bachelor of Science Degree in Agricultural Engineering from the University of Idaho in 1980 and worked for the Idaho Department of Water Resources from June of 1980 to November of 1987. I received my Idaho license as a registered professional Civil Engineer in 1985 and began work at the Idaho Public Utilities Commission in December of 1987. My duties at the Commission currently include case management and oversight of all technical Staff assigned to Commission filings. I have conducted analysis of utility rate applications, rate design, tariff analysis and customer petitions. I have testified in numerous proceedings before the Commission including cases dealing with rate structure, cost of service, power supply, line extensions, regulatory policy and facility acquisitions.

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

A. The purpose of my testimony is to introduce Staff witnesses, identify issues addressed by each and discuss the various policy issues associated with this case.

Q. Could you please describe Staff's filing in this case?

A. Yes. Senior Staff Auditor Donn English presents the Staff test year of July 1, 2006 through June 30, 2007 based on Staff's audit of 12 historical months of actual cost data. He then adjusts the historic test year data for known and measurable changes and develops the Staff revenue requirement based on his proposed expense adjustments, rate base recommendations of Staff witness Stockton, miscellaneous expense adjustments of Staff witness Vaughn, and power supply expense adjustments of Staff witness Sterling. The cost of capital recommendations are discussed by Staff witnesses Carlock and English. Mr. English recommends a revenue requirement increase of $17.45 million or an overall increase of 2.82%. Mr. English specifically addresses proforma adjustments to actual test year O&M expenses, payroll annualization, capitalized pension expenses and legal fees.

Senior Staff Auditor Kathy Stockton addresses the development of rate base proposed by Staff in this case. Ms. Stockton uses an average of 13 monthly average rate base totals for the Staff proposed test year of July 1, 2006 through June 30, 2007 to develop a total rate base of approximately $1.954 billion.

Ms. Stockton proposes reductions in rate base of approximately $15 million. She then utilizes Staff proposed plant investment criteria to increase test year net rate base by $55 million to reflect annualized major plant additions within the test year and annualized and proformed major plant additions beyond the test year.

Staff Auditor Cecily Vaughn addresses several revenue and expense issues including park rents, annualization of insurance to reflect known and measurable changes and amortization adjustments to more appropriately recover intervenor funding and remaining Prairie Power acquisition costs. Ms. Vaughn also addresses the Company's use of P-cards for the purchase of miscellaneous items and recommends an associated expense adjustment. The net effect of Ms. Vaughn's proposed test year adjustments is an increase in Staff's proposed revenue of $16,729 and an increase in base expenses of approximately $2 million.

Senior Staff Engineer Rick Sterling is responsible for review of the Company's Aurora power supply model used to calculate annual net power supply costs. Mr. Sterling proposes an adjustment in the natural gas price forecast used by the Company in its modeling. The results of the forecast modification are a decrease in fuel expenses, system opportunity sales and purchase power costs for an overall decrease in annual net power supply expenses of $6 million.

Senior Staff Engineer Keith Hessing addresses jurisdictional cost allocation, class cost of service (COS), rate design and the PCA load growth adjustment. Mr. Hessing accepts the Company's jurisdictional allocation methodology as reasonable but recommends use of the Base Case cost of service study rather than the 3cp/12cp methodology proposed by the Company. Mr. Hessing has modified the jurisdictional allocation study to reflect adjustments proposed by Staff. He then recommends a rate spread based upon the cost of service study results. Mr. Hessing proposes class revenue requirement changes ranging from no change for some classes where COS suggests declines are warranted to a 10% cap on the increase for the Irrigation class. Other classes are moved to 75% of the increase suggested by the COS. Mr. Hessing recommends an increase of 1.37% for the residential class to generate the overall revenue requirement increase of 2.82% percent.

Mr. Hessing proposes to increase the energy component in each class to generate the additional revenue except for the Irrigation class, which would receive a uniform increase in all rate components.

Finally, Mr. Hessing addresses the issue of the Expense Adjustment Rate for Growth (EARG) also known as the load growth adjustment within the Power Cost Adjustment mechanism (PCA). Mr. Hessing concludes that the methodology described in testimony by Company witness Said does not comply with Commission Order No. 30215. Rather than a $29.16/Mwh variable power supply cost adjustment for customer growth as proposed by Mr. Said, the load growth adjustment should be $62.79/MWh to reflect the entire marginal cost of growth as described in the Commission Order.

As previously mentioned, the cost of capital and return on equity is discussed by Staff witness Terri Carlock. Ms. Carlock recommends a return on equity in the range of 9.25% to 10.75%. Staff's recommended capital structure consists of approximately 51% debt and 49% equity with a recommended return on equity point of 10.25% and an overall recommended rate of return of 7.864%.

Finally, Staff witness Chris Hecht, a Utility Compliance Investigator, will address consumer issues including customer complaints received by the Commission, Company response to customer service requests, and Company compliance with rate case notification rules. Mr. Hecht concludes that customer complaints for the Company are on the decline and the Company does a good job of processing customer service inquiries.

Q. What has been your role in this case?

A. My role as Staff Administrator has been to oversee the preparation of the Staff case with respect to identification of issues, coordination of positions on those issues and development of Staff policy.

Q. What are the important policy issues in this case?

A. In my opinion, the most important policy issues include establishing the rate case test year, identifying revenue requirement adjustments, assigning cost of service responsibility and applying appropriate rate design.

Q. How does the rate case test year filed in this case differ from test years filed in prior cases?

A. In the past two general rate cases, Idaho Power Company provided 6 months of actual booked data and 6 months of forecasted data for use as its test year. The 6 months of forecast/budgeted data was then trued up to actual booked data before the end of the case. For example, the Company filed its case in October of 2003 with actual data through June 2003 and forecasted data through December 2003. By the time rates were put in place on June 1, 2004, and in fact before Staff filed testimony in March 2004, the Company had provided and Staff had audited actual booked data for the remaining 6 months of the test year that had been forecasted. Rates were fully based on actual expenditures.

In this case, the Company has provided 12 months of forecasted data based on budgets for use as its rate case test year. Its filing was made on June 8, 2007 with forecasted monthly expenses and investments for a 2007 test year. While 6 to 8 months of actual 2007 data may be available for review, neither Staff nor the Commission will have actual information for the entire test year before new rates are scheduled to become effective in 2008.

Q. Has the Company always filed a test year with 6 months actual costs and 6 months forecasted costs?

A. No. Past rate case filings have been based on 12 historical months of actual costs. Idaho Power's test year filings in general rate cases have transitioned from a fully historical 12 months of actual costs to 6 months of actual and 6 months of forecasted costs. The Company proposes in this case to use 12 months of fully forecasted costs.

Q. What is the Commission's approach to ratemaking?

A. With few exceptions, the Commission has only approved recovery through rates of costs that have actually been incurred or are known and measurable. The Commission has routinely utilized the principles of "used and useful", "known and measurable" and "expense reducing or revenue producing" in approving an historic 13-month average rate base that includes annualized and proformed adjustments for specific large plant investments. In Order No. 29838, Case No. UWI-W-04-4, the Commission stated,

> To make clear the Commission's preference for future cases, we direct United Water to file future rate cases utilizing a 13-month average rate base methodology. To facilitate an adequate review, Company data should be provided in time to incorporate the information in the prefiled testimony of Staff and other parties.

The Commission went on to say,

> Using recent, actual data for the hearing will reduce if not eliminate the need to argue over forecasts. To this end, the Commission suggest rate cases be filed with no more than six months of forecast data. Not only will data be known and measurable by the time other parties prefile testimony and for the hearing, it will be more convenient and administratively easier for all parties.

In Order No. 29505 in Case No IPC-E-03-13 the Commission said,

> Generally speaking, the Commission expects all utilities to attempt to identify expense savings and revenue producing effects when proposing rate base adjustments for major plant additions. It is unfair to ratepayers to assume that the investment in these plants will not increase Company revenues or decrease Company expenses in the future.

Finally in Order No. 30342, Case No. SWS-W-06-1, the Commission said,

> The Commission has consistently determined that the annual revenue requirement and rates should be the basis of an historic test year.

Q. Why has the Company moved from a fully historical test year to a fully forecasted test year?

A. According to Company witness Gale, the use of an historic test year in combination with increasing marginal costs and a growing customer base causes "regulatory lag".

Q. What is "regulatory lag"?

A. Mr. Gale does not specifically define the term. However, my understanding of "regulatory lag" based on Mr. Gale's testimony is the delay between when the Company actually incurs costs and when the Commission approves rates to recover those costs.

Q. Has anything been done to minimize this delay or its effect?

A. Yes. The Commission allows the actual test year cost information to be adjusted to reflect known and measurable changes in costs that will occur in the future and also allows annualization of known and measurable cost increases to reflect the higher costs for the entire year. In addition, the Commission has allowed the Company to late file actual cost data within the processing of a rate case to further reduce the delay between when costs are incurred and when rates are put in place.

Moreover, the Commission has allowed proforma test year adjustments to include costs associated with significant plant additions that the Company expects to incur beyond the test year. These post-test year additions have been included in the test year as if they have been in service for the entire period. Finally, the delay between when costs are incurred and when rates are put in place to recover those costs has always been a business risk of a regulated utility. I believe that over time the Commission has established returns on equity that reflects overall risk of the Company including that associated with "regulatory lag".

Q. Why are rates normally based on costs that are known and measurable?

A. Rates are based on known and measurable costs to assure ratepayers that expenditures were actually made prior to approving rates designed to recover them, that the expenditures were properly incurred, and that expenditures were properly booked in the appropriate accounts. Absent a demonstration that costs are known and measurable, the Commission is simply left to trust that the Company will actually make expenditures in the amounts assumed, actual expenditures will ultimately be reasonable for the projects proposed and expenditures will be made in the time frames anticipated. A fully forecasted test year based on internally generated Company budgets as the Company has proposed in this case cannot be audited or adjusted because the costs are only anticipated and not yet actually incurred.

Q. How does the Commission review the Company's forecast to determine if it is appropriate?

A. It is very difficult if not impossible to determine if the forecast is appropriate. Because the Company did not provide actual expenditures on which to base rates, comparisons must be made to other historical information to evaluate whether the forecasted expenses are appropriate. A comparison of the forecast to historical data is immediately frustrated because the forecast is based on internal Company budgets that are allocated uniformly to Federal Energy Regulatory Commission (FERC) accounts.

For example, while 2006 FERC accounts show actual expenditures, 2007 forecasted FERC accounts show what the Company has allocated to those accounts based on a uniform allocation methodology, not what would actually be booked in 2007. The Commission will be unable to determine if increases in these accounts from year to year are reasonable because 2007 account totals will not reflect actual expenditures.

A comparison of actual booked account totals for the first half of 2007 is also frustrated because it too compares actual account totals to allocated totals and only reflects a portion of the Company forecasted test year. The Company can easily justify any difference between actual booked 2007 account totals and 2007 forecasted totals in numerous ways such as change in investment/expense requirements or an expectation that account differences will be eliminated by year end.

Q. Why is it important to audit actual Company expenditures?

A. The Commission has a responsibility and an obligation to insure that costs included for recovery in rates were actually incurred, were prudently incurred and were incurred in a reasonable time frame. Only an audit of actual expenditures can provide that assurance. Forecasts based on internal Company budgets that simply allocate costs uniformly among FERC accounts do not allow the Commission to ever really determine whether costs are appropriately incurred. Absent an audit of actual costs, the Commission will be unable to apply the well-established principles of "used and useful", "known and measurable" and "expense reducing or revenue producing" to determine what costs should reasonably be included for recovery through rates. Budget estimates, projections and forecasts do not easily lend themselves to evaluation based on these principles.

Q. What are the reasons the Company asserts it should be permitted to file a rate case with a forecasted test year?

A. The Company maintains that it will not have a reasonable opportunity to earn its authorized rate of return, the investment community will loose confidence in the Company's ability to make necessary investment and earn a reasonable return and borrowing costs included in customer rates will increase.

Q. Do you agree?

A. I agree that reduced returns could increase borrowing costs included in customer rates. However, given that customer rates will increase more quickly with forecasted costs and could also increase as the ability of regulatory Staff to audit actual expenditures is reduced or eliminated, Staff is concerned the unaudited test year approach is likely to have a greater impact on customer rates.

Q. What does Staff suggest?

A. At this time, Staff proposes to continue using and expand on a test year methodology previously approved by the Commission to address the Company's desire to reduce "regulatory lag" by including in rates, major plant investment on a more timely basis. We do this without accepting projected increases in Company cost accounts across the board based on internal Company budgets as proposed by the Company or eliminating the Staff's ability to audit actual Company expenditures.

Q. Would you please explain the Staff's proposal?

A. Yes. Staff proposes to utilize the most recent audited historic test year of July 1, 2006 through June 30, 2007 adjusted to: 1) annualize major plant additions within the test year, that are classified as distribution, transmission or generation investment and exceed a $2 million threshold, 2) annualize or proform for inclusion in the test year plant additions that exceed $2 million during the period July 1, 2007 through December 31, 2007. This approach in this case increases plant in service by approximately $60 million over what was allowed in prior rate cases. Staff witnesses Stockton and Carlock provide additional detail regarding specific rate base annualizing and proforma adjustments.

Q. Do you believe Staff's approach is reasonable?

A. Yes, I believe it is a reasonable alternative to a test year established using an unaudited budget based cost forecast as proposed by the Company. The Staff proposal allows the Commission to pursue its responsibility and maintain its long-standing policy to audit and verify actual known and measurable Company expenditures before they are recovered in rates. At the same time we address the Company's desire to incorporate more recent costs in revenue requirement by focusing on improved cost recovery associated with large plant investment and critical infrastructure.

Q. What adjustments has Staff made to test year results of operations?

A. As indicated previously, Staff has selected the historic test year of July 1, 2006 through June 30, 2007. Besides the proforma and annualizing adjustments to payroll, insurance and other expenses included in test year revenue requirement, Staff has identified known and measurable transmission distribution and generation investment within the test year for special annualization to include the plant in rate base as if it were in service for an entire year.

Staff has also selected additional investment during the last 6 months of 2007 for special annualization or proforma treatment within the test year. Staff believes that special treatment of these plant additions recognizes the significance of the individual investment in terms of impact on Company earnings and the critical nature of the investment to serve new and existing customers. Staff also recognizes that a revenue producing effect of the annualization has been included in the test year and the special treatment of the investment is consistent with plant used in the determination of annual power supply costs.

Staff has also included in its test year determination of annual revenue requirement the Company's calculated power supply expense and revenues at forecasted customer levels. Staff chose to use the Company number due to the forecasted nature of the Company's filing and the fact that customer numbers and associated power supply costs corresponding to Staff's historic test year were very difficult if not impossible to independently develop. Moreover, by utilizing the Company numbers, the Staff was able to adjust test year rate base for some investment made beyond the historic test period. While Staff recognizes that some customer growth is reflected at the end of Staff's proposed historic test year, we also recognize that including variable power supply costs in revenue requirement more than offsets new customer revenue so the net effect on annual revenue requirement is negligible.

Q. What other policy positions has the Staff taken in this case?

A. The remaining policy positions deal primarily with Staff positions regarding power supply modeling, jurisdictional and class cost of service allocation methodology and rate design. Staff positions on these issues were developed in conjunction with the technical Staff who address those issues in testimony filed in this case and are discussed by those witnesses. Generally, it is the Staff's policy to maintain consistency between rate cases with regard to power supply, jurisdictional allocations and class cost of service methodologies. Staff believes its methodologies in this case for these functions adhere to that policy.

With respect to revenue spread it is Staff's policy to generally move classes closer to accepted cost of service in generating the Staff recommended revenue requirement. Given the limited overall revenue increase proposed, Staff recommends a revenue spread that changes class requirements within a relatively narrow range. Likewise, Staff's recommendation to modify rate components depends upon the magnitude of the revenue increase within the class. Staff generally recognizes the limited nature of the overall increase by only increasing the energy rate component for most customer classes.

Q. Are there other issues you wish to address?

A. Yes. Staff's adjustment to remove capitalized pension expense and utilize the correct calculation of the EARG, the load growth adjustment in the PCA, are justified based on decisions made in prior Commission Orders. Staff witnesses sponsoring those issues discuss the relevant Commission Orders and present the rationale' for Staff's position in testimony filed in this case. Generally, the position taken by Staff in this case on these two issues simply applies the principals and positions established by the Commission in prior cases. With regard to the EARG, Staff believes that the incremental approach proposed by the Company fails to properly include the impact of load growth on surplus sales volume and resulting affect on power supply costs.

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

A. Yes, it does.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 10TH DAY OF DECEMBER 2007, SERVED THE FOREGOING **DIRECT TESTIMONY OF RANDY LOBB,** IN CASE NO. IPC-E-07-8, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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