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UTILITIES COMMISSION

BARTON L KLINE
Senior Attorney

May 17, 2007

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

Re: Case No. IPC-E-07-10
Power Cost Adjustment Filing

Dear Ms. Jewell:

Please find enclosed for filing an original and seven (7) copies of the Reply Comments of Idaho Power Company for the above-referenced matter.

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

Very truly yours,

Barton L. Kline

BLK:sh
Enclosures

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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR AUTHORITY TO IMPLEMENT POWER COST ADJUSTMENT (PCA) RATES FOR ELECTRIC SERVICE FROM JUNE 1, 2007 THROUGH MAY 31, 2008	CASE NO. IPC-E-07-10 IDAHO POWER'S REPLY TO THE COMMENTS OF THE INDUSTRIAL CUSTOMERS OF IDAHO POWER

Introduction

In its Comments, the Industrial Customers of Idaho Power ("ICIP") ask the Commission to: (1) initiate a proceeding to change the current PCA methodology; and (2) approve the PCA rates Idaho Power Company ("Idaho Power" or "the Company") has proposed in this proceeding but make the rates subject to refund, pending the Commission's determination of the changes ICIP believes should be made to the PCA methodology.

Idaho Power respectfully requests that the Commission reject the ICIP's requests for the following reasons:

(1) the request to have the 2007-2008 PCA rates placed into effect subject to refund is unfair; and

(2) ICIP's proposed changes to the PCA methodology have already been considered and rejected by the Commission; and

(3) the changes ICIP proposes will create uncertainty, complicate future PCA proceedings and erode the value of the PCA to the majority of the Company's customers.

1. <u>The PCA as Filed Complies with the Commission's Orders</u>.

In its Comments the Commission Staff acknowledges that the Company's filing complies with the Commission's orders and Staff recommends that the Commission approve the PCA rates as filed by the Company. (Staff Comments p. 10).

ICIP did not find any errors or irregularities in Idaho Power's proposed 2007 PCA rates. (ICIP Comments p. 2). Unlike Staff, ICIP does not recommend approval, but states that it does not object to the Commission's approval of the Company's Application. (ICIP Comments p. 2). However, ICIP goes on to request that the Commission make its approval of the rates subject to refund based on the outcome of a future proceeding in which the PCA would be modified as outlined in the ICIP's Comments.

2. <u>ICIP's Last Minute Request to Make the 2007-2008 PCA Rates Subject to Refund is Unfair</u>.

Idaho Power acknowledges that the ICIP has historically supported the PCA and worked cooperatively with the Company and other stakeholders on PCA related issues. Most recently, the ICIP was the entity that first suggested a multi-year sharing of emissions credits. However, in this case, ICIP's motivation for proposing PCA rates subject to refund at a time when the PCA rate for the ensuing year will be *positive* is transparent. As ICIP noted in its Comments on page 3, in the 2006-2007 PCA, ICIP members experienced a 27% PCA rate *decrease*. In 2006 there was no mention of the problem of rate volatility or a need to approve PCA rates subject to refund.

Certainly the Commission can, at any time, initiate proceedings to change the PCA methodology. However, if the Commission chooses to do so, it is preferable that the proposed changes be implemented prospectively and at a time when it is unknown whether a potential change would provide a greater or lesser credit or charge in an upcoming PCA year. Making the PCA methodology change retroactive, as ICIP proposes, provides incentives for parties to take positions that will benefit them in the short term. In Idaho Power's experience, proceedings structured in this manner are likely to be more contentious.

In addition, the financial community carefully monitors the Company's PCA and any uncertainty regarding cost recovery under the PCA is generally viewed negatively.

ICIP's Comments indicate that its proposed PCA methodology changes are intended to be financially neutral. However, on page 1 of its Comments, the ICIP states: "The ICIP is especially concerned with making sure that Idaho Power's rates are *set as low as is reasonable*, while ensuing a level of rate stability that allows its members to conduct their business in an efficient and continuous manner." (Emphasis added). Such a view of utility ratemaking is inconsistent with numerous Idaho Supreme Court decisions and Idaho Code Section 61-502 which require that the Commission set utility rates at levels that are just, reasonable and sufficient. The Commission is required by law to balance the interests of customers and the utility and set rates that are sufficient to allow the utility to recover its costs and earn a reasonable return on its investment. ICIP's view that the Commission should set Idaho Power's rates as low as is reasonable, does not give the Company much comfort that ICIP will, in its proposed future proceeding to change the PCA mechanism, actually pursue a financially neutral approach.

3. <u>The Commission has Already Considered and Rejected ICIP's Proposed Balancing Account</u>.

ICIP recommends that the Commission modify the PCA methodology to implement a balancing account so that "one year's excess and the next year's deficit would be allowed to cancel each other out in the interest of rate stability." (ICIP Comments p. 3).

This balancing account proposal by the ICIP is not a new one. In 1992, when the Commission first considered a PCA for Idaho Power, the ICIP recommended a PCA methodology virtually identical to the one ICIP proposes today. In Order No. 24806 issued in Case No. IPC-E-92-25 on March 29, 1993, the Commission summarized the ICIP's pricing PCA proposal as follows:

> <u>Industrial Customers of Idaho Power (ICIP)</u>
>
> ICIP recommends adoption of a deferred accounting PCA. ICIP's witness, Donald Schoenbeck, argues that Idaho Power's proposed forecast method does not predict actual power supply costs with an acceptable degree of accuracy. The Company's proposal results in adjustments to rates that vary significantly from year-to-year without constraints or limitations. This rate instability is unacceptable to ICIP. *ICIP recommends not adjusting rates until actual power supply costs have deviated from a normalized base level by plus or minus $22.6 million for the Idaho jurisdiction. When the "trigger" point is reached, the entire balance in the deferral account would be passed through to ratepayers as a rate adjustment.* (Emphasis added).

In Order No. 24806 on pages 7-9, the Commission rejected the ICIP's balancing account proposal.[1] The Commission based its decision to use a forecast-based PCA with a true-up rather than the deferred accounting PCA advocated by ICIP on several grounds. Principal among these grounds was the Commission's desire that PCA rates send proper price signals to customers. With a deferred accounting PCA including a balancing account, it is possible that PCA rates would not be adjusted until years after the costs which caused that adjustment had been incurred. Under both the new and the old ICIP proposals, customers that had no role in creating higher costs could find themselves paying higher PCA rates simply because they happen to be customers on the system when the "balancing account" called for a PCA rate increase.

In Order No. 24806 the Commission also noted that a forecast-based PCA, like the current PCA, is preferable to the deferral PCA advocated by the ICIP, because Idaho Power's customers are aware of changing stream flow conditions and understand the impact they have on the cost of generating electricity. A PCA that adjusts rates to reflect projected stream flows for the coming year sends the correct short-term price signals to the ratepayers in a way this is very understandable to customers. The current PCA methodology, in contrast to the balancing account advocated by ICIP, provides a closer link between cost causation and cost recovery.

ICIP's proposed balancing account and three year smoothing proposal would eliminate all of the price signals the Commission found desirable in Order No. 24806. In addition, ICIP's proposal could create multiple offsetting charges and credits within

[1] A copy of the pertinent portions of Order No. 24806, in which the Commission addresses ICIP's proposal, is attached to these Comments for the convenience of the Commission.

overlapping three year periods, all of which add complexity and the potential for customer confusion.

CONCLUSION

In summary, the issues ICIP raises in its Comments were considered by the Commission when it issued Order No. 24806 in 1993. The proposal ICIP presents in its Comments in this case is essentially the same proposal the ICIP made in 1993. In Order No. 24086 the Commission considered ICIP's proposal and determined that the current methodology is preferable for Idaho Power. Of course, if the Commission desires to revisit the PCA methodology it certainly can do so. However, Idaho Power believes it would be unfair for the Commission to consider retroactive changes to PCA methodology at a time when a positive PCA charge is on the horizon. If the Commission wants to review PCA methodology, it should do so prospectively, not retroactively as ICIP requests.

Based on the foregoing, Idaho Power respectfully requests that the Commission approve Idaho Power's PCA rates as proposed and that the Commission decline the ICIP's invitation to initiate a proceeding to make major changes to the current PCA methodology.

DATED this 17th day of May, 2007, at Boise, Idaho.

BARTON L. KLINE
Attorney for Idaho Power Company

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 17th day of May, 2007, I served a true and correct copy of the within and foregoing upon the following named parties by the method indicated below, and addressed to the following:

Donald L. Howell, II Deputy Attorney General Idaho Public Utilities Commission 472 West Washington Street Post Office Box 83720 Boise, Idaho 83720-0074	( ) U.S. Mail, Postage Prepaid (X) Hand Delivered ( ) Overnight Mail ( ) Facsimile (X) Email: Don.howell@puc.idaho.gov
Peter J. Richardson Mark R. Thompson Richardson & O'Leary, PLLC 515 N. 27th Street Boise, Idaho 83702	( ) U.S. Mail, Postage Prepaid ( ) Hand Delivered ( ) Overnight Mail ( ) Facsimile (X) Email: peter@richardsonandoleary.com mark@richardsonandoleary.com

Barton L. Kline

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

CASE NO. IPC-E-07-10

IDAHO POWER COMPANY

ATTACHMENT 1

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR AUTHORITY TO IMPLEMENT A POWER COST ADJUSTMENT TARIFF FOR ELECTRIC SERVICE TO CUSTOMERS IN THE STATE OF IDAHO AND FOR APPROVAL OF NEW RATES FOR SERVICE UNDER THE FMC SPECIAL CONTRACT.	CASE NO. IPC-E-92-25 ORDER NO. 24806

APPEARANCES

FOR IDAHO POWER COMPANY:	LARRY D. RIPLEY Idaho Power Company PO Box 70 Boise, ID 83707-0070
FOR COMMISSION STAFF:	MICHAEL S. GILMORE BRAD M. PURDY Deputy Attorneys General Idaho Public Utilities Commission Statehouse Boise, ID 83720-6000
FOR FMC CORPORATION:	CONLEY WARD, JR. Givens, Pursley & Huntley 277 N. 6th Street, Suite 200 PO Box 2720 Boise, ID 83701-2720
FOR INDUSTRIAL CUSTOMERS OF IDAHO POWER:	GRANT TANNER PETER J. RICHARDSON Davis Wright Tremaine 702 W. Idaho Street, Suite 700 Boise, ID 83702-8908
FOR IDAHO IRRIGATION PUMPERS ASSOCIATION:	RANDALL C. BUDGE Attorney at Law Racine, Olson, Nye, Cooper & Budge, Chartered 201 E. Center PO Box 1391 Pocatello, ID 83204-1391

explains 66% of the variation. In spite of CUC's concerns over the degree of Idaho Power's forecasting accuracy, CUC's witness David Eberle testified that he could not design a regression that would improve forecasting accuracy. In fact, Mr. Eberle testified that he had not tried to improve the accuracy of Idaho Power's regression technique.

Eberle pointed out that the National Weather Service's forecast inflows for Brownlee can vary significantly from actual inflows. Because Idaho Power relies upon this single variable as the benchmark for forecasting power supply costs, Eberle contends, there is a potential for rate instability. Eberle attempts to address this problem by proposing a "deadband" which will be discussed below. CUC does not propose a specific forecast method other than that recommended by Idaho Power.

Idaho Irrigation Pumpers Association (Irrigators)

The Irrigators recommend a forecast-based PCA that is different from the Company's proposal. The Irrigators' witness, Anthony Yankel, argues that the forecast should not attempt to predict 12 months of usage and cost but should include three months of actual information and nine months of estimated data to be essentially based upon a calendar year. Mr. Yankel contends that such a method explains 84% of the variations in power supply costs. Rate adjustments based on his method, however, would not coincide with the forecast period.

Federal Executive Agencies (FEA)

The FEA recommends adoption of Idaho Power's forecast proposal.

Industrial Customers of Idaho Power (ICIP)

ICIP recommends adoption of a deferred accounting PCA. ICIP's witness, Donald Schoenbeck, argues that Idaho Power's proposed forecast method does not predict actual power supply costs with an acceptable degree of accuracy. The Company's proposal results in adjustments to rates that vary significantly from year-to-year without constraints or limitations. This rate instability is unacceptable to ICIP. ICIP recommends not adjusting rates until actual power supply costs have deviated from a normalized base level by plus or minus $22.6 million for the Idaho jurisdiction. When this "trigger" point is reached, the entire balance in the deferral account would be passed through to ratepayers as a rate adjustment.

Commission Staff

The Commission Staff presented the testimony of witnesses Bill Eastlake and Keith Hessing. Mr. Eastlake testified as to what he considered to be an improved forecast-based PCA. Eastlake argues that Idaho Power's forecast method is a poor predictor of power supply costs. He recommends modifying Idaho Power's proposal by substituting a linear regression technique which uses the natural logarithm of stream flows for the linear regression technique the Company proposed in its Application. According to Eastlake, a logarithmic fit produces a higher degree of accuracy in forecasting power supply costs. The Company accepted Mr. Eastlake's use of a log fit regression as an improvement to its forecast methodology.

Mr. Hessing advocates a deferred accounting PCA. This is Staff's primary recommendation. Under Hessing's method, 50% of the difference between actual and normalized power supply costs would be placed into a deferral account. When that account balance reached plus or minus $11.9 million for the Idaho jurisdiction, the accumulation would be passed through to ratepayers with a rate adjustment.

FINDINGS

We find that a forecast-based PCA with a true-up is most appropriate for Idaho Power. A forecast most closely matches costs to the time period in which they are incurred. This sends the more appropriate price signals to ratepayers. Under either of the deferred accounting PCA's proposed in this case, it would be possible that rates would not be adjusted until years after the costs which caused that adjustment had been incurred. A PCA based on a forecast does not suffer as greatly from this defect.

Ratepayers in Idaho Power's service territory are aware of changing stream flow conditions and understand the impact they have on the cost of generating electricity. A PCA that adjusts rates to reflect projected stream flows for the coming year should be understandable to ratepayers and send short-term price signals to ratepayers more reflective of actual conditions than rates set using normalization.

The ability of a forecast-based PCA to send correct price signals and to appropriately time the recovery of costs depends, of course, upon the accuracy of the forecast. We share the concerns of the Staff and ICIP that if Idaho Power's forecast is seriously in error, it may result in a true-up larger than the primary adjustment. This impairs the ability of the PCA to send proper price signals. It also diminishes rate stability. We accept Idaho Power's agreement to use a logarithmic method for correlating forecasted Brownlee inflows with estimated power supply costs. Other provisions of this Order with respect to sharing, interest computation, and recognition of load changes will also mitigate against the predictive inaccuracy of the model. We intend to monitor the results of Idaho Power's PCA over the coming years. If it appears that the degree of accuracy is inadequate, we will revisit the issue.

Finally, we find that a forecast-based PCA that trues-up to actual, as proposed by Idaho Power, eliminates the possibility of the Company over-recovering its power supply costs.

Sharing

Two forms of sharing were proposed in this case: "deadbands" and "percentage splits." Essentially, "sharing" is any method that provides for something less than a 100% pass-through of actual power supply costs to ratepayers.

Idaho Power

Idaho Power proposes to pass 100% of actual power supply costs through to ratepayers. Although the Company's proposal uses a base of normalized power supply costs in calculating the annual adjustment to rates at the beginning of each year, that base becomes irrelevant when the Company trues-up to actual costs at the end of each year.

Idaho Power cites two specific benefits to its proposal. First, a 100% pass-through of costs maximizes earnings stability for the Company. Idaho Power asserts that this is an important benchmark used by financial rating analysts and is critical to the Company's continuing financial health.