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IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC SERVICE.	)	CASE NO. IPC-E-08-10

IDAHO POWER COMPANY

DIRECT REBUTTAL TESTIMONY

OF

STEVEN R. KEEN

Q. Please state your name.

A. My name is Steven R. Keen.

Q. Are you the same Steven R. Keen that has previously presented direct testimony in this proceeding?

A. Yes.

Q. Have you reviewed the direct testimony and exhibits filed by the Commission Staff relating to cost of capital in this proceeding?

A. Yes. My comments will relate primarily to the testimony provided by Staff Witness Ms. Carlock as well as the testimony of Mr. Matthew I. Kahal on behalf of the U.S. Department of Energy ("DOE") and testimony of Dr. Dennis E. Peseau on behalf of Micron Technology, Inc. ("Micron") concerning return on equity ("ROE")

Q. What have you concluded based on your review of these testimonies?

A. I would first state that I agree with the representations made by the Company's expert witness, Dr. Avera, in his rebuttal testimony. The conclusions drawn by Ms. Carlock, Mr. Kahal, and Dr. Peseau are indeed biased downward and I think the rebuttal testimony of Dr. Avera does an excellent job of directly categorizing the shortcomings of each of the other recommendations. I do appreciate that Mr. Kahal acknowledges that Idaho Power's current risk profile is high by choosing a recommended rate of return that is at the high end of his range of estimates. His recommended rate of return is also higher than the last return authorized for the Company by the Idaho Public Utilities Commission ("IPUC") in the litigated 2003 rate case so as to reflect a relative shift higher, albeit slight, based on increased risks.

Q. What are the primary drivers for your assessment that the Staff-, DOE-, and Micron- recommended returns on equity are too low?

A. I look to three factors. First of all, history suggests that these recommended levels of return will yield actual returns on equity in the single digits. The returns from years 2003, 2004, 2005, 2006, and 2007, illustrated in LaMont Keen's Exhibit No. 1, speak for themselves. In those years, granted or implied allowed ROEs of 10.25 percent and 10.6 percent delivered actual earnings well below 10 percent.

Second, the rating agencies have clearly indicated that the Company has experienced significant stress and is in a less secure position today than in the past. Since the year 2000, as illustrated in LaMont Keen's Exhibit No. 2, credit ratings for Idaho Power have been on a steady march downward. The ratings trend from A+ to A- to BBB+ to

BBB again speaks for itself. This decline will not be turned or halted without some improvement in the Company's allowed return on equity. In 2003, the Company's allowed ROE was 10.25 percent. In 2005, the Company's Idaho Case No. IPC-E-05-28 was settled and resulted in an implied ROE of 10.6 percent. Ms. Carlock, Mr. Kahal, and Dr. Peseau all argue to reduce the allowed return on equity at the very time an increase is required. The downgrades from the rating agencies send a clear and united statement to the regulating agencies that the Company is more at risk today, from a bond holders perspective, than it was five years ago. The interests of equity investors fall behind those of the bond holders so their risks are at least equally raised.

Finally, I look to the recent events in the financial marketplace as indicators that the risks this Company is facing now are greater than anyone considered when original testimony was filed. Admittedly, much of the market turmoil has been realized very recently and may not have been adequately factored into prior direct testimony, but current market conditions signal much higher levels of risks in terms of both cost and availability for all capital. Mr. Kahal indicates he did not include any impact of the financial crisis in his 10.5 percent ROE recommendation. His reason for not doing so is that he feels it would not be proper to set fair rate of return based on a crisis which likely will be temporary. Yet how could it be fair to completely ignore any impact from a financial crisis that may well be the largest in more than 50 years? As Dr. Avera noted in Figure 1 of his rebuttal testimony, bond yields have skyrocketed since September of this year. Apparently, bond investors are choosing not to ignore the implications of this particular crisis.

Q. If the Commission adopts Staff's recommendations, will the Company be able to earn an adequate and reasonable rate of return in the year 2009?

A. No. I do not believe the Staff's recommended 10.25 percent return on equity is an adequate, risk adjusted return for the Company. I also do not believe the full compliment of Staff recommendations will allow the Company to earn anywhere close to an actual return of equity of 10.25 percent. The Staff has not adequately reflected the risks associated with serving load in an environment of rising costs, limited resources and constrained capital, especially in light of the recent turmoil in the financial markets.

Q. In its testimony, the Commission Staff makes allowances for elements of a forecast test year that are intended to compensate for the effects of regulatory lag. Do you agree with the conclusions of Staff witnesses that Staff's recommendations will properly compensate the Company for regulatory lag?

A. No. In my opinion, if the Commission adopts the Staff's recommended approach to a forecast test year, the Company will not be properly compensated for regulatory lag and will not be able to earn an actual rate of return anywhere near the allowed rate. The Company continues to experience increasing costs and faces needed investment in aging generation and transmission systems that will not be recovered if the significant reductions in allowed costs under the Staff's methodology are implemented.

Q. Do the recent economic challenges stemming from the financial crisis offer relief from dealing with growth issues and rising costs?

A. Partially. While the economy is certainly expected to be negatively impacted by the financial crisis and prospects for growth much lower, I have not heard a single projection that would indicate that growth would completely stop or reverse in the Company's service territory.

Q. Since you filed your direct testimony, has any new data been presented which addresses Idaho's construction and growth prospects?

A. Yes. In the October 2008 Idaho Economic Forecast, housing starts are projected to range from roughly 9,300 units in 2008 to slightly over 13,000 units in 2011. While these projections are significantly lower than the 18,000 to 20,000 unit figures in recent years, they still portray growth that will require investment to maintain infrastructure in Idaho. Significant generation and transmission infrastructure investments are needed in our service territory that cannot be completely eliminated even if customer growth stops.

Q. Do you agree with Staff Witness Ms. Carlock that the Company's low cost hydro generation is a benefit to the Company?

A. No. In fact, Idaho Power's low cost hydro generation exacerbates the Company's rate recovery difficulties. The benefit of the Company's low cost hydro is passed on to the Company's customers in the form of low rates. When the Company must add new investment to serve the new loads, the new costs are high when compared to the Company's low embedded costs. The Company is met with price resistance and there is a considerable lag between cost occurrence and cost recovery.

Q. Ms. Carlock also commented on the role of rating agencies in the ratemaking process. Would you add any additional comments to her observations?

A. Yes. I continue to appreciate that Ms. Carlock recognizes that the services of rating agencies are important to the Company. In addition to impacting the borrowing costs and the costs of investor supplied capital, as noted by Ms. Carlock, credit rating decisions can actually impact a company's access to capital. Turmoil in the financial markets in 2007 and again more significantly in 2008 demonstrated that lower credit ratings could actually result in limited or complete inability to utilize some financial products such as commercial paper.

Rating agencies ultimately look at how commission decisions manifest themselves in the actual financial performance of a company. Risk reducing mechanisms and adjustments established in a regulatory environment are important and closely monitored by rating agencies. How these mechanisms and adjustments actually affect the financial health of a company is of even greater importance. It is the effect of the regulatory decisions on a company's actual financial performance that is most critical. In light of this, it is again hard to overlook the recent downward ratings changes and actual earnings results that are far below allowed rates of return and not see the need for corresponding recommendations for higher returns on equity.

Q. Do you have any specific information on the commercial paper issue you just mentioned?

A. Yes. Idaho Power's current commercial paper ("CP") rating of A-2, P-2 recently put the Company in a difficult liquidity situation regarding the issuance of CP. CP issuers carry a rating of A-1, A-2, or A-3 by Standard and Poor's and P-1, P-2, or P-3 by Moody's, with A-1 and P-1 being the most highly rated. Of the three ratings criteria for CP issuance, Idaho Power is in the middle tier. When CP markets became very volatile this fall and rates skyrocketed, issuance of CP became nearly impossible for all companies. A government program designed to improve issuance of commercial paper was implemented fairly quickly by the U.S. Federal Reserve but it only included purchase allowances for companies in the top tier rated A-1, P-1. As a result, companies with that rating have had much less difficulty issuing commercial paper and have done so at more competitive rates.

CP in Idaho Power's category of A-2, P-2 has experienced pricing increases from roughly 3 percent this summer to in excess of 6 percent in October. Instead of being able to issue CP with maturities of weeks or months, the only available maturities at certain times in October were limited to days, or even overnight. As a result of this credit squeeze, the Company was forced to utilize a loan feature provided for in its credit facility. On October 7, 2008, the Company drew down a swing-line loan of $30 million to accommodate short-term liquidity needs. The loan was subsequently repaid when issuance maturities beyond overnight were again available.

Q. Is that an unusual circumstance for the Company?

A. Yes. Drawing on credit facilities is very rare and is a situation all companies try to avoid. To my knowledge, this is the first time Idaho Power has been forced to use this liquidity mechanism.

Q. Can you explain why this occurrence is relevant here?

A. Yes. The reason I mention it here is that it is a very direct signal that the Company is currently operating in a time of significant financial stress. On page 9 of his direct testimony, Mr. Kahal referred to the situation as "a serious economic crisis that has required historical and remedial action by U.S. and foreign governments." It is indeed serious and the Company-specific liquidity issues point out that the impacts are real and affecting Idaho Power today. It also points out that having weaker credit can cause detrimental results. The increased costs from this short-term borrowing is a very real stress on the actual results for the Company and it demonstrates why higher rates of return on equity are warranted during times of financial distress.

Q. Do you have any comments regarding interest rates and equity markets in light of comments made by Staff Witness Carlock?

A. I do. In regard to interest rates, Ms. Carlock cites a decline in the prime rate, which is one benchmark for short-term borrowing, and also mentions that the federal funds rate and other rates had also decreased. I do not disagree with those observations; however, benchmark rates are merely a starting point for interest charges to be incurred by a regulated utility. Banks and other lenders charge a spread above the benchmark rates depending on perceived borrowing risks. That spread is added to the benchmark treasury rate to form the coupon rate of interest. This rate ignores an additional small increase for costs of issuance, but it is a good rate for comparison purposes.

For example, on July 7, 2008, the Company issued long-term debt with a ten-year term at a coupon rate of 6.025 percent. That rate included a spread to the Treasury of 215 basis points over and above the benchmark ten-year Treasury rate of 3.875 percent. Roughly six months earlier, that spread to Treasury was closer to 100 basis points and the trend of rising spreads has continued. At the end of October 2008, the benchmark Treasury rate for ten-year bonds was roughly the same as in July; however, the spread to Treasury for Idaho Power would have added over 400 basis points. The coupon rate would have been close to 200 basis points higher than in July of this year. Since the end of October, the Treasury rates have declined further but not nearly as much as the spread to Treasury has risen.

The point is that the interest cost to the Company has actually risen significantly over the course of the year, which puts additional stress and risk on funding future capital needs.

In addition to that stress on debt issuances, equity prices have fallen significantly. On October 31, 2008, the Company stock was trading 24 percent below its starting point for the year. While the Company's share price held up relatively well compared to peer companies, that significant decline in equity value is an additional stress upon the Company's financial viability.

Q. What are industry experts saying in regard to interest rates and the relative issuance spreads going forward?

A. The consensus is that spreads will remain wider and that the current higher level of coupon issuance rates will not improve in the near term. As noted in Figure 1 of Dr. Avera's rebuttal testimony, corporate bond yields have seen precipitous increases since September of this year. Those increases are primarily the result of increased spread, or perceived risk, over benchmark Treasuries. With Treasuries already extremely low, reductions in debt costs will only come when the market feels more confident about corporate debt in general, thus allowing spreads to contract.

Q. Do you recommend any other changes to the capital structure?

A. I do not recommend any change at this time but note that there will be actual outcomes that differ from the Company's projections. I continue to believe that a forecast methodology is an appropriate and reasonable benchmark for setting our cost of capital. However, Staff has introduced modifications for various components of this filing based on a review of actual expenditures to date and I feel compelled to acknowledge that changes have also occurred in regard to cost of capital.

In my proposed capital structure, I have included projected costs of debt related to planned debt issuances for both taxable and non-taxable debt. One of those issuances occurred on July 7, 2008. The original projection for this issuance was $125 million at a rate of 5.53 percent for ten-year bonds. The actual issuance was for $120 million at a rate of 6.025 percent for ten years.

The other planned issuances relate to the Company's Pollution Control Revenue bonds for both Sweetwater and Humbolt Counties. The projected interest rates utilized in the Company's embedded cost of debt schedule were derived from pricing estimates as of April 10, 2008, and related to planned issuances for these securities; Idaho Power anticipated the bonds would be outstanding at fixed rates until maturity of each bond. The rates Idaho Power is currently being quoted for this type of issuance are significantly higher than in the Company's forecast. Estimates are now roughly 100 basis points higher than our assumed 5.75 percent rate as originally filed.

Q. Are there any other components of the current debt structure that are impacted by market changes?

A. Yes, Idaho Power has one additional series of variable rate debt outstanding, the Port of Morrow Series 2000, due 2027, and that variable rate was originally proposed based on a five-year historical average. The updated average rate for five years through September 30, 2008, would be 3.070 percent, which is slightly higher than the filed rate of 2.978 percent.

Q. Do you wish to add any other comments regarding the financial crisis and how it may potentially impact ROE recommendations?

A. I do want to add some specifics to the quote from Mr. Kahal's testimony. While this certainly is a "serious economic crisis," I think it is important to reflect on the significance and magnitude of events that occurred in September and October of this year before dismissing too quickly that this situation is temporary or that equity holders will not be factoring in higher risk expectations going forward.

Here is a brief time line for perspective:

Sept. 7: Federal takeover of Fannie Mae and Freddie Mac

Sept. 14: Bank of America buys Merrill Lynch

Sept. 15:	Lehman Brothers files for bankruptcy
Sept. 17:	Federal Reserve Loans $85 billion to AIG to avoid bankruptcy
Sept. 19:	Paulsen rescue plan unveiled
Sept. 25:	WaMu seized by FDIC, sold to JP Morgan
Sept. 29:	Bailout defeated in the House of Representatives
Sept. 30:	CITI announces FDIC-backed acquisition of Wachovia
Oct. 1:	Senate passes revised bailout
Oct. 3:	Wells Fargo announces merger with Wachovia; Bailout signed into law
Oct. 6:	Federal Reserve announces $900 billion in short-term loans to banks
Oct. 8:	Federal Reserve reduces emergency lending to 1.75 percent
Oct. 10:	End of the worst week for stock market in 75 years.
Oct. 14:	US Announces injection of $250 billion into US banking system
Oct. 15:	US monthly retail sales drop 1.2 percent and DJIA drops 7.87 percent
Oct. 28:	US consumer confidence falls to record low of 38
Oct. 30:	Federal Reserve announces Federal Reserve Funds Rate cut of .5 percent to 1 percent

Q. Have these events moderated since October?

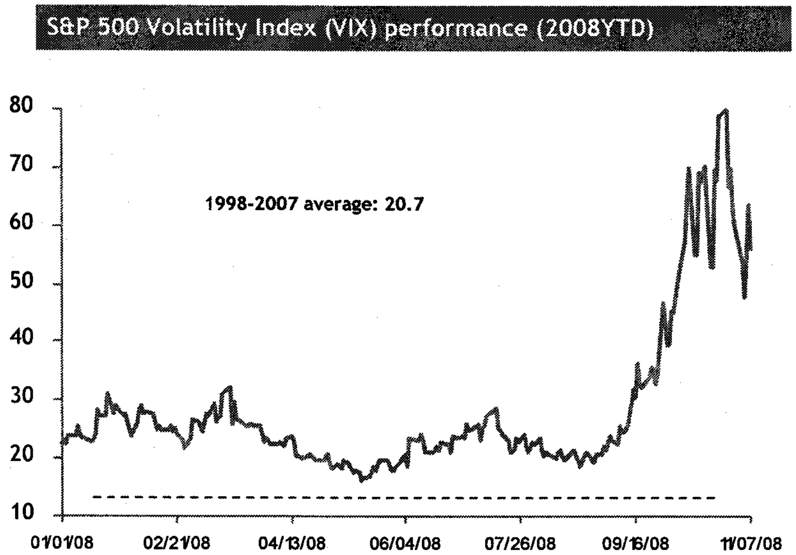
A. The frequency of events may be slowing but the reactions in the financial markets continue to be severe. On December 1, 2008, the U.S. economy was officially deemed to have been in a recession and the Dow Jones Industrial Average plunged 679 points. The fourth-largest point decline since this index was created in 1986.

Q. Did you factor in any allowance for the type of financial market changes outlined above that occurred during 2008 when you filed your original testimony?

A. I did not foresee or account for the level of volatility that has occurred in the financial sector. The current financial turmoil is itself a risk factor that was in no way considered when I filled my original testimony.

Q. Are these levels of volatility unique?

A. Most certainly. Below is a chart that was provided to me by J.P. Morgan and it represents the S&P 500 volatility index, or VIX. This index is commonly used in the financial community as a measurement of volatility. Typically volatility has the effect of increasing risk and as you see, the level of volatility in the current financial market is extreme. Recent levels depict volatility as high as four times greater than the average over last prior decade.



Q. In your original testimony, you make reference to the difficulties of achieving actual earnings that equal allowed levels of return. Will this current financial turmoil impact the Company's ability to achieve allowed earnings results?

A. The increased volatility raises uncertainty and the market is currently translating that uncertainty into higher risk-adjusted costs to all forms of capital, which in turn will make it harder to achieve allowed earnings results.

Q. In your direct testimony you indicated that potential improvements in the mechanism utilized to recover power supply costs ("PCA") could influence your recommended rate or return on equity. Do you have any additional comments to add in that regard?

A. Yes. There has certainly been progress on the PCA and assuming the new methodology is implemented, I feel it will improve the risk profile of the Company. This enhancement should deliver a very modest benefit to the earnings ability of the Company and a greater benefit to the management of cash flows. While this enhancement is significant, it does not entirely close the gap between my recommended return on equity and the 10.25 percent recommended by Staff. I also did not anticipate the severe changes that have occurred in the financial markets since that testimony was filed and the significant negative those events introduced in the determination of equity return.

I would simply observe that these two events have occurred, one positive and one negative. The positive event is significant for the Company but did not remove 100 percent of the exposure Idaho Power experiences due to weather and water related fluctuations in its hydroelectric generation. The negative event is significant historically to the entire world and I cannot predict what the ultimate effect will be on Idaho Power. I will simply say that I continue to feel the recommendations for rate of return on equity by Staff, the DOE, and Micron are too low.

Q. Does this complete your direct rebuttal testimony?

A. Yes.