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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF IDAHO POWER COMPANY'S PETITION FOR APPROVAL OF CHANGES TO ITS POWER COST ADJUSTMENT (PCA) MECHANISM	**CASE NO. IPC-E-08-19** **COMMENTS OF THE COMMISSION STAFF**

The Staff of the Idaho Public Utilities Commission, by and through its Attorney of Record, Weldon B. Stutzman, Deputy Attorney General, submits the following comments in response to Order No. 30677 issued on November 13, 2008.

BACKGROUND

On May 30, 2008, the Idaho Public Utilities Commission issued Order No. 30563 in Case No. IPC-E-08-07, Idaho Power Company's annual Power Cost Adjustment (PCA) for 2008/2009. In that Order the Commission stated:

> With respect to further evaluation of the PCA mechanism, Staff, Idaho Power, and the Irrigators all proposed workshops to address issues such as sharing methodology, forecasting methodology, the distribution of power cost deferrals, and load growth adjustment rates. We support these proposals and direct Idaho Power to schedule such workshops as soon as practicable.

The first PCA workshop was held on July 30, 2008, with Idaho Power Company, Commission Staff, and representatives from Micron Technology, the Industrial Customers of Idaho Power and the U.S. Department of Energy all participating. The workshop participants agreed to discuss the following six PCA issues:

1) Customer/Company power cost sharing in the PCA. The PCA currently requires that cost be shared on a 90%/10% basis, respectively.
2) The PCA load growth adjustment rate (LGAR). The LGAR is currently $62.48/Mwh but is applied to only 50% of the load growth as specified in the Commission approved settlement in Case No. IPC-E-07-13.
3) Third party transmission expense. This expense is not currently tracked through the PCA.
4) The methodology used to forecast power supply costs in the PCA. The PCA currently uses anticipated inflows to Brownlee reservoir to forecast power supply costs.
5) The distribution of expected power supply costs over the PCA year. The current distribution is based on monthly modeled power supply costs.
6) The distribution of PCA cost among customer classes. PCA costs are currently assessed on an equal ¢ per kWh basis to all customer classes.

After the first workshop, it became clear that resolution of the issues would require extensive negotiations of all the parties in an attempt to reach an acceptable consensus. Consequently, two additional settlement workshops were held on August 13 and September 3, 2008 with the additional participation of Irrigation class representatives. On October 14, 2008, Idaho Power Company filed a PCA Settlement Stipulation, developed as a result of the workshops and signed by all participating parties.

The Stipulation

The Stipulation, filed as Exhibit No. 1 to Mr. Said's testimony lays out each of the six issues identified in the workshops, describes the existing situation, the proposed solution and the rationale for the recommended change. The first issue addressed is the Sharing Methodology. Since the inception of the PCA, annual deviations in normalized power supply costs have been shared 90%/10% by customers and Company shareholders, respectively. If costs were below normal, customers received 90% of the windfall. If costs were above normal customers paid 90% of the excess costs while the Company paid 10%. The Stipulation changes the sharing percentage to 95%/5% in recognition that while the Company should continue to have incentive to make wise resource acquisition decisions, increases in power supply cost volatility and development of the Company's Risk Management Policy justifies the change.

The second issue addressed is the Load Growth Adjustment Rate (LGAR). The LGAR is part of the PCA mechanism intended to remove the power supply expense effects of load deviations due to weather, growing customer totals or changing customer usage patterns. The current LGAR is calculated by multiplying the marginal cost of serving new load by one half of the difference between current load and that established in the last rate case. The current rate is effectively $31.39 per Mwh. The new methodology recognizes that the Company actually incurs additional power supply costs to serve new load between rate cases and has no opportunity to collect those costs. It also recognizes the generation related revenue that is collected from new load through rates. The proposed new rate is $28.14 per Mwh.

The third issue addresses the PCA forecast. The current power supply forecast is based on estimated stream flow into Brownlee Reservoir. Load and natural gas prices used to estimate power supply costs are established in the last rate case. The parties all agree that the current forecast methodology results in unreasonably large true ups after the fact. The parties also agree that forecasting power supply costs based on the Company's existing Operating Plan will improve the forecast and reduce future true ups.

The fourth issue addressed is third party transmission expense. These expenses have not historically been tracked through the PCA as are other variable power supply expenses. Because these expenses vary in relation to power purchase and sales, the parties agreed that they should reasonably be reflected in the PCA calculation.

The fifth issue addressed is Power Supply Expense Distribution. Power supply expenses have historically been reported monthly based on a computer modeled distribution. The parties agreed that the power cost distribution should be reported based on monthly revenue shape to improve the information provided to the financial community regarding the relationship between interim and annual reporting periods to better match cost allocation with revenues.

The filed Stipulation resolves all but one of the issues identified in the first workshop. The sixth issue of whether the PCA rate should continue to be spread to all customer classes on an equal ¢ per kWh basis will be reevaluated after completion of the Company's current general rate case. Settlement on the remaining issues identified in the first workshop was arrived at through frank and comprehensive discussions and Staff believes represents a fair and reasonable compromise.

STAFF ANALYSIS

For analysis purposes, Staff divided the six issues identified above and addressed in the Settlement into two separate categories, those that affect the amount of power supply costs recovered by the Company and those that do not. The proposed PCA modification to sharing percentages, the LGAR and transmission cost recovery will all impact power supply costs the Company will recover and the PCA rates that customers ultimately pay. The other categories impact timing and cash flow.

It should be reiterated that the PCA is designed to be symmetrical in that in good water years, power supply costs are below normal and customers receive a credit. In poor water years power supply costs are above normal and customers pay a surcharge. None of the changes agreed to in the Stipulation will change the theoretical symmetry of the PCA. However, over the past seven years poor water conditions have resulted in an overall customer PCA surcharge every year. To the extent poor water conditions continue, the proposed changes will increase customer PCA cost responsibility over what it would be with the current sharing ratio. Conversely, if water conditions are above normal, customers will receive a larger benefit than they otherwise would have received.

PCA Sharing

The proposed change that impacts customer rates most significantly is the modification in the sharing percentages. The Company provided information at the workshops showing the magnitude of power supply costs borne by Company shareholders each year from 2001 through 2007 and the affect those costs had on the Company's overall equity return. The Company's share of above normal Idaho jurisdictional power supply costs during the period totaled approximately $100 million or 95 basis points of equity return per year.

The Company maintains and Staff does not dispute that modeled power supply scenarios in 1992, when the PCA was first established, showed annual power supply cost volatility of approximately $100 million dollars. Applying the 10% Company sharing to power supply costs resulted in an impact of approximately 50 basis points of Company earnings. With power supply cost volatility modeled today in the $330 million range, the impact on Company earnings is approximately 100 basis points. Staff recognizes that greater power supply cost volatility could have a significantly greater impact on Company earnings.

In evaluating justification for reducing the sharing percentage, Staff looked at various sharing alternatives to determine potential customer impact. Applying the 95%/5% ratio to the period 2001 to 2007 would have increased customer costs by approximately $47 million. Staff maintained at the workshops that any reduction in the Company sharing percentage and a potential increase in customer costs must be accompanied by quantifiable benefits to customers or other compelling rationale.

The Company's underlying rationale for changing the sharing percentage is the detrimental effect current sharing has had on Company earnings and credit quality as measured by national credit rating agencies. The Company asserts that the existing PCA sharing percentage has resulted in a lower credit rating and higher borrowing costs to the detriment of customers. By lowering the sharing percentage, the Company maintains that credit ratings could increase and interest costs on debt could decline to the benefit of customers. Staff does not necessarily believe this to be the quantifiable benefit needed to justify lowering the Company sharing percentage. Staff believes there are many other factors that contribute to a Company's credit rating. There is no guarantee that credit rating would improve to any particular level based on a reduced sharing percentage or that lower interest rates on debt would generate sufficient quantifiable savings for customers.

However, Staff does recognize that changing power supply cost volatility has increased the exposure of the Company over time. Lowering the Company's exposure in low water years undoubtedly will enhance its ability to earn its authorized rate of return. Staff also recognizes that the Company has taken significant steps to collaboratively approach resources acquisition and mitigate over all power supply cost risks. The unrecovered power supply costs over the last seven years equates to a larger average reduction in earnings than was originally contemplated. At the same time, the Company has developed a risk mitigation program with customer advisory oversight (RMC) and developed resource acquisition customer advisory groups for Integrated Resource Planning (IRPAC) and demand side management (the EEAG). These programs with customer and Commission participation have helped direct the resource acquisition decisions of the Company and to a greater extent than before helped to determine power supply costs that flow through the PCA.

Staff continues to believe that the interest of Company customers and shareholders should still be aligned by giving the Company incentive to make cost effective resource decisions through sharing of PCA power supply costs. Given the potential for lower interest costs, the increased volatility in power supply cost and improved collaborative resource acquisition programs of the Company, Staff believes that a 95%/5% sharing for customers/company is fair, just and reasonable.

The Load Growth Adjustment Rate (LGAR)

The treatment of growth related power supply costs in the PCA have been an issue since the PCA was originally established in 1992. Staff has maintained that the PCA was designed to track changes in power supply costs due to changing water conditions and energy prices. It was not established to automatically track increased power supply costs associated with growing load between rate cases.

Because actual booked power supply costs, including growth related costs, are compared to normalized power supply costs without load growth, growth related costs are automatically included in the PCA without an LGAR. The Commission recognized this fact and originally established an LGAR of $16.84/Mwh. Staff believed this rate generally reflected the cost to serve new load on the margin at the time. Then in 2007, the Commission confirmed Staff's belief and increased the LGAR to $29.41/Mwh to reflect a more current marginal cost to serve new load.

The Company has maintained that the cost of serving new load between rate cases should be recovered through the PCA. It believes that failure to recover the growth related power supply costs at the margin between rate cases places an undue burden on Company shareholders and that only the variable power supply revenue embedded in rates of approximately $7/Mwh should be subtracted from PCA deferral balances.

In Case No. IPC-E-07-13 the Commission approved a comprehensive settlement that established the LGAR at its current level of $32.14/Mwh. The rate is based on a marginal cost to serve new load of $64.28/Mwh but is applied to only 50% of the load growth.

The LGAR of $28.14/Mwh proposed in this case recognizes the magnitude and financial impact of serving new load at today's marginal cost, the obligation of the Company to incur new load related variable power supply cost between rate cases and the inability of the Company to recoup these expenditures after the fact through general rates. The proposed LGAR also recognizes that revenue embedded in new customer rates will offset a significant portion of the growth related power supply costs.

Staff believes that the methodology using marginal power supply costs and power supply revenue embedded in rates as established in a general rate case provides a sound basis to calculate an appropriate LGAR. The agreement on an LGAR methodology represents a reasonable compromise and finally resolves the issue in a fair and equitable manner for the Company and its customers. The specific methodology is shown in Company Exhibit No. 1, the Settlement Agreement, Exhibit A.

Third Party Transmission Expense

Including third party transmission expenses in the PCA seems to be a straight forward treatment of power supply costs that fluctuate with PCA power purchases and sales. These expenses are incurred by the Company when transmission is purchased from third parties outside the Company's transmission network. These costs have not historically been tracked through the PCA even though they are directly associated with the level of off system sales and purchases.

Company analysis showed that while transmission expense can fluctuate from year to year it is difficult to directly correlate these costs with water conditions. Nevertheless, the Company estimates that up to $12.5 million in transmission power supply costs above and beyond those included in base rates have been borne by Company shareholders over the past seven years. The parties agreed that transmission cost approved by the Commission in the Company's most recent rate case will provide a reasonable basis for normal transmission expenses in the PCA. For example, actual 2007 third party transmission costs were in the $13 million range. To the extent these costs are approved for base rate recovery, they will also be used as the basis for determining extraordinary transmission expense in the PCA going forward. Staff agrees that these costs are incurred in conjunction with market purchases/sales and should be tracked through the PCA subject to sharing like other variable power supply costs.

Forecast and Expense Distribution

The remaining issues addressed in the Settlement Stipulation do not affect the overall PCA cost responsibility between customers and shareholders. The first such issue identified by all parties for needed change was the forecast of PCA power supply costs. All parties agreed that the PCA forecast was badly flawed and sent inaccurate and improper power supply price signals.

The primary reason for forecast inaccuracy is the methodology used to make the power supply cost estimate. The forecast is currently based on a forecast of river inflows based on snow pack and then those river inflows are input into a regression formula derived from the base power supply model to calculate Company power supply costs. Inaccuracies in the river flow forecast and the power supply modeling create errors in the power supply forecast when compared to expenditures that actually occur. More importantly, the system load and the gas price forecast used in the power supply model are based on information established in the last general rate case. The combination of internal modeling inaccuracies and outdated load/gas price data has resulted in a significant underestimation of power supply costs and very large PCA true-ups.

Staff, along with the other parties to the case, agrees that use of the Company's Operating Plan (OP Plan) provides the best forecast available for use in the PCA. The Operating Plan is continually updated based on gas prices, loads, resources, water conditions and other power supply variables. It is the defacto forecast used by the Company to actually meet system load throughout the year. It is also an integral part of the Company's Risk Management Program and is subject to review by Staff and customers as part of the risk management customer advisory group. Staff believes the Company OP Plan will more accurately forecast power supply costs thereby sending a more accurate price signal to customers and thus reduce the magnitude of subsequent true-ups.

The distribution of power supply expenses throughout the year used for comparison to actual expenses has historically been based on the monthly power supply model output. This distribution has created confusion in the financial community by inappropriately showing huge swings between expected and actual earnings on a quarterly basis and earnings that eventually result on an annual basis. Staff agrees that use of the monthly revenue shape to report Base Net Monthly Power Supply Expenses will improve information dissemination to financial entities without sacrificing appropriate accounting for PCA purposes. The parties agree that modeled power supply costs on a monthly basis will be tracked with PCA expense deferrals and reported to the Commission Staff.

Finally, Staff agrees that it is reasonable to investigate the rate spread/revenue allocation that has historically been used in the PCA. Traditionally, PCA costs have been spread on an equal ¢/kWh basis to all customer classes because these costs have been allocated on an energy only basis in Commission approved cost of service studies. Various parties to the case believe that if variable power supply costs tracked through the PCA are allocated in a general rate case based on demand and energy, then extraordinary PCA costs should also be allocated on demand and energy. The need to pursue this issue further is dependent upon how the Commission determines that PCA costs should be allocated through cost of service in the pending general rate case.

Conclusions

For the reasons cited above, Staff believes that the Stipulated Settlement filed by the Company in this case represents a fair and reasonable resolution of the issues originally identified by the Commission and discussed in the workshops. Staff recommends that the Settlement, signed by all participating parties, be approved by the Commission.

Respectfully submitted this 3rd day of December 2008.

Weldon B. Stutzman
Deputy Attorney General

Technical Staff: Randy Lobb

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 3RD DAY OF DECEMBER 2008, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. IPC-E-08-19, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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