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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
MODIFY ITS RULE H LINE EXTENSION
TARIFF RELATED TO NEW SERVICE
ATTACHMENTS AND DISTRIBUTION
LINE INSTALLATIONS.**

CASE NO. IPC-E-08-22

BUILDING CONTRACTORS ASSOCIATION OF SOUTHWESTERN IDAHO

DIRECT TESTIMONY

OF

RICHARD SLAUGHTER

ORIGINAL

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

2 A. My name is Richard Slaughter. My business address is 907 Harrison Blvd, Boise, Idaho
3 83702.

4 Q. Have you prepared a statement of your qualifications to offer testimony in this
5 proceeding?

6 A. I have. It is attached to this testimony as Attachment A. Expanding on the qualifications
7 detailed in Attachment A, between 1998 and 2001 I consulted in Kazakhstan and
8 Kyrgyzstan on tax policy and revenue estimation. The work in Kyrgyzstan was
9 supported by the Asian Development Bank ("ADB"). My report can be found in ADB
10 Technical Assistance No. 3106-KGZ, Benchmark Report Section V "Economic and Tax
11 Analysis." The implications of that work for third world economic development are
12 presented in the Summer 2002 issue of *The National Interest*, a public policy journal.
13 My comments on the Former Soviet Union (FSU) and third world economic development
14 are grounded in my academic work in international politics and economics, almost fifty
15 years as a close observer of the Soviet Union and comparative politics, my work as Chief
16 Economist for the Idaho Division of Financial Management, and my consulting work in
17 the region.

18 Q. Are you offering any exhibits in support of your testimony?

19 A. Yes. I am sponsoring Exhibits 201 through 204.

1 Q. What is the purpose of your testimony?

2 A. I have been asked by the Building Contractors Association of Southwest Idaho (“BCA”)
3 to provide to the Commission my analysis and opinions concerning Idaho Power
4 Company’s (“Idaho Power” or “Company”) proposed Rule H tariff modifications.

5 Q. Have you previously testified before this Commission?

6 A. Yes. In 1995 I provided testimony to the Commission on behalf of the BCA concerning
7 proposed modifications of the Company’s Rule H tariff in Case No. IPC-E-95-18. I also
8 have testified in numerous other cases before this Commission involving avoided cost
9 and cost of capital.

10 Q. Please summarize the scope of your analysis concerning the Company’s proposed Rule H
11 tariff revisions.

12 A. I have reviewed the Company’s Application and supporting testimony in this proceeding
13 and the Company’s responses to Staff and BCA production requests. I also have
14 reviewed the pleadings, testimony and exhibits and Commission Orders in the
15 Company’s prior Rule H tariff proceeding, IPC-E-95-18, as well as subsequent
16 Commission orders having relevance to the Company’s cost of service, avoided costs and
17 embedded costs and rates, including the Commission’s recent Order No. 30722 in the
18 Company’s 2008 rate case, IPC-E-08-10. I also have analyzed available economic data
19 relative to inflation and cost pressures on Idaho Power’s rate base.

1 **Summary**

2 Q. Will you also please summarize testimony?

3 A. My testimony addresses four primary areas. First, I will discuss why the Company's
4 proposed tariff modifications are inconsistent with the Commission's existing policy
5 statements and with economic theory. Second, I will testify concerning the fallacy in
6 Idaho Power's assertion that increased distribution costs are driven by growth itself, as
7 opposed to inflation. Third, I will address the adverse economic impacts of adopting the
8 Company's proposed tariff modifications. Fourth I will propose an updated basis for
9 computing the appropriate allowances and administering vested interest refunds.

10 **Company rationale and Commission policy**

11 Q. What is your understanding of the Company's intent in filing in this case?

12 A. In his testimony on behalf of the Company, Greg Said has made clear that Idaho Power
13 desires ultimately to impose the full marginal cost of growth (including costs of new
14 generation, transmission and distribution) on new development to eliminate the upward
15 pressure that the addition of new facilities imposes on rates. This Rule H filing is merely
16 the opening salvo in the Company's strategy.

17 Q. Can you provide support for that conclusion from Mr. Said's testimony?

18 A. Yes. The following colloquy from Mr. Said's testimony describes that intent, and
19 includes Mr. Said's admission that Idaho Power ultimately is as interested in transferring

1 generation and transmission costs to new customers as it is in transferring line extension
2 costs:

3 “Q. Please describe the instructions you gave to Mr. Sparks regarding the
4 improvements that the company desired be made to Rule H.

5 “A. I identified three primary goals for Mr. Sparks to achieve. ... Third, I asked Mr.
6 Sparks to take a close look at line installation allowances and refunds with an eye
7 toward reducing both allowances and refunds.

8 “Q. Why is the Company desirous of reducing line installation allowances and
9 refunds?

10 “A. As the Commission is well aware, the Company has filed general rate case
11 proceedings in 2003, 2005, 2007, and 2008. In addition, the Company has also
12 filed cases for the inclusion into rate base of the Bennett Mountain gas-fired plant
13 in 2005 and the inclusion of the Danskin gas-fired plant in 2008. With the recent
14 frequency of rate proceedings, a persistent question arises: Is growth paying for
15 itself? The clear answer is no. Additional revenues generated from the addition
16 of new customers and load growth in general is not keeping pace with the
17 additional expenses created and required to provide ongoing safe and reliable
18 service to new and existing customers. While the provisions of Rule H have
19 required some contributions in aid of construction for new distribution facilities,
20 there are no requirements for contributions in aid of construction for new
21 transmission or generation facilities which [sic] are also typically required to
22 serve customer growth. Reducing the Company’s new customer-related
23 distribution rate base by reducing allowances and refunds will relieve one area of
24 upward pressure on rates and will take a step toward growth paying for itself.”
25 [Said, DI, p. 5, l 23 to p. 6, line 22] (emphasis added).

26 This statement, together with Mr. Said’s instructions to Mr. Sparks to “take a close look
27 at line installation allowances and refunds with an eye toward reducing both allowances
28 and refunds [SAID, DI, p. 4, lines 20-22],” is clear indication that Idaho Power desires
29 that new connections pay the full marginal cost of capital. His language suggests a belief
30 that rates should forever be stable in nominal terms, and declining in real terms, for those
31 customers who are currently on the system and who never move to a new residence.

1 It is also telling that Mr. Said's instructions were for the purpose of arbitrarily "reducing
2 both allowances and refunds." There is no attempt whatsoever to lay a theoretical or
3 empirical base for the Rule H proposal. He does not, except in the most general
4 conventional wisdom sense, tie the proposal to changes in the Company's specific costs,
5 nominal or real.

6 Q. Does Mr. Said suggest that it will be the Company's policy to recover from new
7 customers the marginal costs for expansion of Idaho Power's generation and transmission
8 plant?

9 A. Yes, that would appear to be the case.

10 Q. Please explain.

11 A. Mr. Said complains that "growth does not pay its way." He states that all areas of the
12 Company's costs have been rising, and attributes those increases to growth, citing several
13 Company rate cases over the past decade. He then instructs Mr. Sparks to design
14 proposals that would "take a step toward growth paying for itself." There is no other
15 logical interpretation to make.

16 Q. What has been the Commission's public policy record on this issue?

17 A. Broadly speaking, in IPC-E-95-18, the Commission determined that new customers
18 should receive credit for the embedded costs of providing distribution/terminal services.
19 In Order 26780, the Commission found, among other things, that:

1 • ... new customers are entitled to have the Company provide a
2 level of investment equal to that made to serve existing customers in the
3 same class; and

4 • To the extent that any allowance is ordered, some portion of
5 distribution cost will continue to be recovered through rates. [Order
6 26780, IV (C) Commission Findings, ¶ 2.]

7 Q. What rationale supports this policy?

8 A. In part, it is the recognition that unless new customers receive credit for their
9 contributions to the cost of new facilities *and* some or all of the embedded costs of
10 existing distribution/terminal facilities, then the rates for existing customers are
11 suppressed below the actual cost of service, which in turn suppresses the consumer's
12 incentive to limit his or her electricity use.

13 Q. Please explain.

14 A. Embedded distribution costs greatly understate both the replacement cost and the
15 economic value of distribution services. As will be described later in my testimony, the
16 ratepayer pays for current depreciation and for return on capital for the un-depreciated
17 portion of the distribution system. Because the economic life of the system is longer than
18 the depreciation period, much of the existing system costs nothing in rate schedules, even
19 though value continues to be provided to the ratepayer.

20 Q. Is there other rationale supporting the Commission's decision in IPC-E-95-18?

21 A. Yes. In the 1995 Rule H case, the BCA provided evidence concerning the adverse
22 economic impacts that would result if new customers were required under the Company's

1 proposed Rule H Tariff modifications to pay all costs of new distribution facilities in
2 excess of embedded investment. The Commission specifically found that requiring
3 payment of all these costs from new customers could have severe economic effects.

4 Q. Has the Commission's recognition of the rationale and policy in been carried forward in
5 subsequent orders?

6 A. At least with respect to its policy of sending appropriate market signals to the Company's
7 customers, yes. The Commission has quite recently affirmatively recognized that the
8 need to constrain unbridled demand growth requires that more accurate market signals be
9 provided to customers. For example, average cost pricing, by design, has protected Idaho
10 Power customers from the full effects of inflation and of the costs of fuel switching and
11 other changes in the cost of delivering energy.

12 In IPC-E-08-10, the Commission adopted the Company's proposed "inverted block" rate
13 schedule for residential customers, in which an initial block at lowest price was set at
14 approximately 60% of the average residential monthly use, with a higher price for energy
15 in excess of that monthly amount. The Commission also continued to support higher
16 rates for summer use, in recognition of the fact that residential summer demand
17 contributes to the Company's peak demand. The Company proposed, and the
18 Commission approved, an increase in the rate differentials between the Tier 1 and Tier 2
19 blocks to 20%, to recognize higher summer energy cost, and to "send a stronger price

1 signal to customers encouraging the efficient use of energy. ..." [IPC-E-08-10 transcript,
2 p. 728].

3 Q. Does the Company's Rule H proposal conform to both the Company's above-described
4 intent concerning its residential rate proposal in IPC-E-08-10 and Commission policy?

5 A. No. In fact Idaho Power's current Rule H modification proposal is diametrically opposed
6 to the Company's IPC-E-08-10 proposal and the Commission's decision.

7 Q. In what way?

8 A. The proposed Rule H seeks to place the full marginal cost of distribution system
9 expansion onto "new" customers. Rather than sending a price signal to existing
10 customers that capital cost inflation exists, it seeks to remove growth entirely from rate
11 base. This would cause rate base to gradually decline over time due to depreciation.

12 The only distribution inflation reflected in rate base under the Company's proposal
13 accrues because of system maintenance and replacement, if, as, and once it occurs.

14 Because the economic life of distribution plant tends to be longer than the depreciated
15 life, un-depreciated distribution plant, and thus rate base, will decline over time.

16 Consequently, rates will not reflect the actual (higher) cost of service or the increased
17 (and accruing but not-yet-incurred) cost of maintenance and replacement of the existing
18 distribution system.

1 Q. What effect would Commission support for the Company's current Rule H proposal have
2 on ratepayers?

3 A. It would undercut the price signal the Commission's decision in IPC-E-08-10 was
4 intended to provide by removing inflation from a major component of energy costs. This
5 is a subsidy to existing customers. Causing customers to believe that energy costs less
6 than it actually does will cause overall demand to rise above the level that might be
7 expected from current policy.

8 **Rising costs, inflation, and market signals**

9 Q. Is there reason to believe that Mr. Said is confusing nominal with real costs, and that the
10 nominal costs for new terminal services do not in fact represent "higher costs of growth?"

11 A. Yes. The conclusion that "growth does not pay its own way" can only be reached by a
12 simple comparison of embedded distribution costs with that of new service. In Mr.
13 Said's view, since new service costs more than the average of the existing rate base, rapid
14 growth results in nominal rate increases.

15 Q. Is Mr. Said's comparison accurate?

16 A. No, because Mr. Said is comparing apples and oranges. First, as mentioned earlier, the
17 Company's existing system contains substantial distribution assets that are fully
18 depreciated. Thus, even if inflation were zero, Idaho Power's embedded costs would be
19 below that of new plant, simply because the economic life of new plant is longer than the

1 depreciation schedules. Second, the Company's existing system is of lower quality and
2 capacity than new plant because of its age. As a result, the additional distribution system
3 provided for new customers is of significantly higher quality, has a higher capacity, a
4 longer expected life, and lower maintenance costs than the aging, depreciated system that
5 existing customers are charged for as part of their rates.

6 Q. Please elaborate.

7 A. For the past quarter century the portion of Idaho served by Idaho Power, particularly the
8 Treasure Valley, has grown rapidly. This growth is consistent with current public policy
9 of the State, the City of Boise and business and public entities in the Treasure Valley. It
10 has caused Idaho Power's overall distribution system to be younger than it otherwise
11 would be. While one result is rising average costs, the reduction in average system age
12 also will cause maintenance costs to be lower than would otherwise be the case –
13 reducing costs down the road. In other words, new customers who generate the need for
14 new distribution plant, in the long run, reduce real costs for all customers.

15 Q. So growth is not a cause of real cost increases?

16 A. No. To quote my prior testimony, "growth, especially accelerating growth, will cause the
17 effects of an underlying cost change to be felt more quickly. In itself, however, growth
18 does not cause higher costs. In inflation adjusted terms, if the same facilities are
19 provided at the same real unit cost, then average real cost per customer will not change.
20 This is true regardless of the rate of growth."

1 Q. Did you provide an example?

2 A. Yes. Exhibit 203 illustrates four hypothetical customers coming onto the system over
3 four years, each requiring a \$100 investment. The investments in the example have a
4 four-year life, depreciated straight line.

5 As the illustration shows, total depreciation cost does indeed grow, until after the fourth
6 year, when the last customer is added. From that time forward, depreciation cost remains
7 constant. Even adding replacement investment does not cause the total cost to rise.
8 Average cost remains constant over the period. Absent inflation, growth cannot cause
9 per customer cost to rise.

10 This example demonstrates that the phrase "growth should pay for itself," while an
11 appealing political slogan, is devoid of analytical insight insofar as it relates to costs of
12 service.

13 Q. Is there a reason why Commission policy should discourage the artificial aging of the
14 distribution system?

15 A. Yes, there are several. First, artificially suppressed energy prices encourage excess
16 demand, and result in higher costs later, as the Commission recognized in Order No.
17 30722 when it approved an inverted-block rate structure for the Company. Second,
18 extending the economic life of distribution assets to hold rates down can have adverse
19 economic consequences.

1 Q. Please give examples:

2 A. Example 1:

3 In the former Soviet Union (FSU) the government used heavily subsidized utilities as a
4 social safety net, in a centrally-directed economy in which markets and prices as we
5 know them did not exist. Subsequent to independence, it has been politically impossible
6 for governments to charge rates sufficient to support the existing utility infrastructure.
7 The result in the FSU has been a steady deterioration of transmission and distribution
8 plant, with increasing outages and insufficiently reliable service to support economic
9 growth:

10 “Estimates of electrical power consumption show that a full third is lost to poor
11 quality transmission and distribution systems Much of the electrical usage is
12 not metered or the meters not read. Additionally, despite the extremely low price,
13 much of the power is not paid for, especially in rural areas. As such, it amounts to
14 a *de facto* subsidy to the poorest in the population. The price paid for the subsidy
15 is an unreliable and inadequate supply.” [Asian Development Bank Technical
16 Assistance No. 3106-KGZ Benchmark Report – Economic and Tax Analysis,
17 Page V-25]

18 “For most consumers, there is little incentive to conserve electricity and much
19 incentive to waste gas. Our house in Jalal-Abad had an electric furnace, while the
20 cookhouse had a gas stove and a gas-fired heater for washing and for the sauna.
21 The electricity was metered at six mills per kilowatt—about a fifth the cost of its
22 production and delivery. The gas was metered, too, but because the meter only
23 had three digits, the monthly bill was negotiated with the meter reader. Our
24 landlady would regularly turn the electric furnace off at six every morning, in
25 freezing weather, to save ‘that expensive electricity,’ but she cared less about the
26 gas, even though the burners are so crude that they waste most of the energy used.
27 We once fired the sauna for four hours; because the gas pressure was low, it
28 would not heat to the required temperature. From the standpoint of the individual
29 consumer, such profligate behavior is entirely rational.” [Richard Slaughter, “Poor
30 Kyrgyzstan,” *The National Interest*, Summer 2002]

1 While no one expects Idaho Power's system to deteriorate to anywhere near this extent,
2 real examples exist to validate economic theory regarding subsidies, market signals and
3 demand in the context we are discussing here today. The policy proposed in the current
4 proceeding attempts to hide from ratepayers the true economic value of the services they
5 receive, and in so doing encourages excess consumption. The following example
6 illustrates that while not as acute, the same problem does exist within Idaho Power's
7 system:

8 Example 2:

9 The distribution system in Boise's North End, like much of the Company's service
10 territory, is several decades old. When that system was placed in service, the average
11 home did not have today's array of computers, kitchen appliances, saunas, hot tubs, air
12 conditioners, and other electrical consumers. Today, the distribution system built to
13 serve a typical 1940s load can be incapable of handling current demands:

14 "In December 1990 we were living in Boise's North End on 18th street. It
15 was extremely cold with periods of lows in the -20 degree range and some
16 daily highs not exceeding zero. During the later part of the month we
17 experienced reoccurring power outages. During one of the outages I
18 talked with an Idaho Power lineman who was working to restore power in
19 the alley behind our house. I asked him why the system wasn't staying on,
20 even after repair. He told me in older areas, like the North End, since the
21 lines were put in, homes now had significantly more electronic items –
22 electric heat, microwaves, computers, television sets, etc. – that put a load
23 on the system that was higher than anticipated when the system was built.
24 Therefore, due to the higher loads per household, during an extremely
25 cold period like we're having, the system couldn't keep up." [Don
26 Reading, former IPUC Policy Administrator, anecdote from personal
27 experience while living on 18th street in Boise]

1 This is anecdotal evidence. But for customers in many of Boise's older neighborhoods,
2 Dr. Reading's description of his experience over 18 years ago could be a fair statement of
3 their own contemporary service experience in cold, or hot, or windy circumstances.

4 Another example occurred in the late 1990s when an Idaho Power transmission line,
5 heated by high load, shorted on a tree in southern Idaho causing multiple hours' power
6 outage in several states.

7 Q. Your first example compares modern utility regulation with the collapse of a centrally-
8 directed economic system. Is that appropriate?

9 A. More than Idaho Power may realize. While Idaho Power enjoys a monopoly-lock on its
10 electrical customers, unlike modern telephone or cable companies, it does not enjoy a
11 lock on all energy customers, and fuel switching is not only possible, it is practiced.
12 Unlike the Soviet-controlled energy supply and distribution system discussed above,
13 Idaho Power does not have control over its own customers' choices. Idaho Power's
14 existing customers can and do shift portions of their overall demand between energy
15 sources in response to changing non-subsidized natural gas and oil prices.

16 Q. Please give an example.

17 A. There are three specific areas, each of which undercuts the Company's view that new
18 growth is the primary contributor to higher costs. First, most of the Company's existing
19 customers have the capacity to substitute electric heat, through room heaters, for gas or

1 oil. As gas and oil prices rise relative to electricity, those substitutions can be and are
2 being made.

3 Second, there is a growing national movement to replace gasoline with electricity
4 for short-distance automotive commuting. While the proposals generally envision
5 capturing existing off-peak capacity through “smart grids” and nighttime recharging,
6 these emerging energy policies and technologies inevitably will result in requirements
7 from existing customers for more generation and transmission.

8 Third, average electricity consumption is rising, as it has for the past half century.
9 Homes now feature multiple televisions, computers, hot tubs, saunas, laundry equipment,
10 outdoor lighting, air conditioning, and many other electric consumers – many of them
11 never fully turned off – that did not exist in prior years. These demands come from
12 existing, as well as new, customers, and are a reason for the demand management
13 policies discussed earlier.

14 Q. What does this mean for the Company’s underlying thesis?

15 A. There are two effects, which together mean that this attempt to protect existing customers
16 from energy costs is futile and self-defeating. The attempt should be abandoned.

17 Q. Please elaborate.

18 A. First, it is the policy of the State and local governments throughout Idaho, and of Idaho
19 Power for all of my memory going back to the 1950s, to encourage demand growth.

1 From the days of "Reddy Kilowatt" until Idaho Power recently became capacity
2 constrained, growth has been deliberately sought on the basis of low hydro energy costs.

3 Q. How does the Company propose to handle the conflict between the attraction of low
4 energy prices and its capacity constraints?

5 A. As a short-term strategy, the Company recently completed a customized sales agreement
6 with a new industrial facility, Hoku Materials, whose demand exceeds 25 MW, for the
7 purpose of managing the costs of this specific large industrial expansion. [Order No.
8 30748, Case No. IPC-E-08-21] Demand up to 25 MW is to be supplied through the
9 existing large industrial tariff, while demand in excess of that amount is to be supplied at
10 the existing PURPA avoided cost rate. That rate represents Idaho Power's cost of
11 additional energy and capacity in lieu of its marginal energy costs from capacity that is
12 no longer in surplus. For the longer term, the conflict is not resolved.

13 Q. What is the second effect you referred to?

14 A. The second effect is fuel switching by existing customers, as described earlier. Thus, low
15 electricity prices attract growth, both industrial and residential, which results over time in
16 new requirements for capacity and transmission. Further, customers can and will
17 substitute fuels to save money. You cannot have it both ways, as the Company is
18 attempting to do with this proceeding. *The attempt should be abandoned.*

19 Q. Why is it useful to examine the source of nominally higher distribution costs?

1 A. As I explained in my testimony in IPC-E-95-18, rising costs for new distribution plant
2 can be attributed to only three sources: reduced density, inefficiencies, and inflation.

3 The first two of these sources can be dismissed:

4 • Density: If new construction is, on average, less dense than existing construction, then
5 for the most part the associated costs are accounted for in installation work orders. For
6 that reason, lower density should not contribute to higher average costs because the
7 developer or new customer capitalizes line extensions. Additionally, much residential
8 growth is to be found in high-density development. Thus, while the average single-
9 family residential lot (and associated common area or open space) may be larger than it
10 used to be, the average line and terminal facilities costs may not be.

11 • Inefficiencies: If the Company or its contractors have become less efficient, then they,
12 and not new growth, will have caused real, as well as nominal, costs to rise. I am not
13 aware of any facts disclosed in this proceeding that would indicate that the Company or
14 its contractors have become less efficient over time, and for the purpose of this discussion
15 I will assume that Idaho Power and its contractors have not become progressively less
16 efficient over time.

17 • Inflation: The third potential cause for increased distribution facilities costs is
18 inflation or increases in commodity or labor. In my opinion, inflation is the reason for
19 higher costs of new distribution facilities.

20 Q. Why does this matter for the Company's proposed tariff modifications?

1 A. Inflation is a rise in the general price level, or put another way, a depreciation of the
2 currency. Rising commodity or labor prices contribute to higher costs, but in so doing
3 they also raise the nominal value of existing plant in the same way they contribute to
4 increases in the nominal value of other assets, including houses. Since these price
5 changes alone do not change the real economic value of all distribution services, and
6 because, as explained earlier, new facilities present lower ongoing costs to the system
7 than existing plant, there is no rationale for protecting existing ratepayers from those
8 costs.

9 Q. In his pre-filed direct testimony, a portion of which you quoted above, Mr. Said poses,
10 and then answers, the question "is growth is paying for itself?" His answer is that
11 "clearly the answer is no." Do you agree?

12 A. I do not agree. The only way to agree with his statement is to fully discount the facts
13 that: 1) existing customers contribute to the need for new generation, transmission and
14 distribution facilities when their energy consumption rises; 2) the nominal embedded
15 investment in existing plant is far less than both replacement cost and economic value; 3)
16 inflation is the source of higher nominal costs for new plant; and 4) new customers result
17 in the installation of higher quality facilities that have lower maintenance costs, which
18 tends to lower average costs for all ratepayers.

19 Contrary to Mr. Said's conventional wisdom, growth DOES pay its own way. Actually,
20 for the reasons discussed above, growth pays more than its own way when it pays costs

1 above embedded cost. That is because the plant purchased by new development is un-
2 depreciated and higher quality than the plant represented by embedded costs. For
3 existing customers to receive this new plant at zero cost represents a large transfer of
4 capital value from new customers to existing customers. This shift of capitalization from
5 the Company to the customer also represents a major change in utility regulatory policy,
6 where normally the customer effectively leases the use of plant from the Company. The
7 Company's continued legal ownership and control of new plant further supports this
8 view.

9 Q. Is this a new revelation? Are these arguments based on new facts?

10 A. No. These facts were before the Commission in 1995, and supported the Commission's
11 findings in Order 26780 addressing the question of the level of support to be provided
12 new customers by the Company. The Commission's finding in this regard bears
13 repeating here:

14 "We find that new customers are entitled to have the Company provide a
15 level of investment equal to that made to serve existing customers in the
16 same class. Recovery of those costs in excess of embedded costs must
17 also be provided for and the impact on the rates of existing customers is an
18 important part of our consideration. We also recognize that requiring the
19 payment of all costs above embedded investment from new customers
20 could have severe economic effects." [Order 26780, IV. C. Commission
21 Findings, ¶ 2]

22 **Economic effects of the proposed rule**

23 Q. You have testified that the Company's proposal would further shift the capital cost of
24 new distribution services from rate base to the developer, and by implication, to the home

1 purchaser. The home purchaser, of course, continues to pay for embedded capital costs
2 through rates. Does this capital shift have economic impacts other than “growth paying
3 its way?”

4 A. Yes. Because assessed valuation for all properties in a taxing district are impacted by the
5 prices of new residences, it has a potential impact on property taxes as well as affecting
6 the overall market and the ability of individuals to purchase houses.

7 Q. Have you an illustration of how this works?

8 A. Yes. In a colloquy from my IPC-E-95-18 testimony, I explain the process. Note that
9 much of the problem arises from the fact that a cost formerly capitalized in the
10 Company’s rate base is now (for new customers only) *also* capitalized in the price – and
11 thus assessed value – of their house:

12 “A. ... I have shown that the ‘cost of new distribution facilities,’ to the extent
13 they are higher than embedded costs, are higher because of inflation, not
14 changes in the nature of the facilities. I have also demonstrated that
15 growth itself does not cause higher costs. What the existing customer sees
16 when rates rise is an adjustment of his payment to more closely reflect
17 current market value, NOT a new cost for which there should be a “new
18 benefit.” Further, there is no benefit delivered to the new customer [that]
19 the existing customer does not already enjoy.

20 “Q. Is there is an offsetting cost reduction for the ratepayer, such that for all
21 ratepayers there is a zero impact?

22 “A. Unfortunately, no. There is prospectively an offsetting benefit from reduced
23 rates in the future. Because the fee becomes capitalized in the price of the
24 house, however, it has other undesirable consequences.

25 “Q. Please elaborate.

1 "A. In the longer term, a cost increase of between \$1200 and \$3000 to the
2 developer will result in a price increase for the finished house of from
3 \$2000 - \$4000, since both developer and builder must mark up their costs
4 to cover overhead and profit. At the higher ranges it will have a definite
5 effect on the ability of buyers to enter the market, and on the payments of
6 all home buyers.

7 "Q. Can't they just buy an existing home, as suggested by one witness?

8 "A. No, because the price increase for new properties will be reflected in existing
9 properties as well. New and existing homes are economic substitutes for
10 each other. Since additions to the supply of housing must for the most
11 part be new homes, the cost of development and construction sets the
12 value of older homes as well. Aside from differences in physical
13 condition and location, the value of any existing house is determined by its
14 replacement cost.

15 "Q. That sounds as though the increase would create new wealth for all existing
16 homeowners, much as when the price of a stock rises. Why is that bad?

17 "A. Because it has occurred for artificial, non-economic reasons, and because
18 higher values tend to translate into higher property taxes. It is quite
19 possible that existing ratepayers might find themselves paying more in tax
20 than they save in rates.

21 "Q. Can you roughly calculate the relative effects?

22 "A. Yes. Assume that the additional cost is \$3000 to the developer, and a total of
23 \$3500 to the homeowner. At 8% interest, the monthly mortgage would
24 rise by \$23. Since Idaho law currently allows local government full
25 recovery of value for new property, his tax bill will rise by an estimated
26 1.5% of \$3500, or over \$4 per month. The increased monthly cost, which
27 would add about 4% to the average mortgage, would have a significantly
28 negative impact on the ability of some individuals to purchase acquire
29 financing.

30 "Q. Please estimate the rate savings.

31 "A. Initial savings on rates would of course be zero. By the end of ten years,
32 assuming that 1¢ per kwh of current rates is for distribution and that
33 portion would otherwise grow by 3% per year, the monthly savings for all
34 customers would be .35¢ per kwh, or \$3.50 per month.

35 "Q. What then is the net savings?

1 "A. The new customer is obviously worse off by \$27 per month from the
2 beginning, because he is paying not only the additional fee but also
3 interest on amortization of that fee. The existing customer is also worse
4 off. His property tax, given whatever lag is necessary for assessment and
5 services budgets to catch up with his increase, will have risen an estimated
6 \$4 per month. He must wait for a period in excess of ten years for the
7 savings on rates to amount to that much."

8 Q. Aside from the Company's current intent (as extrapolated from Mr. Said's testimony) to
9 shift the entire marginal cost of growth (including all costs of new generation,
10 transmission and distribution) to new development, what if anything is different from its
11 current tariff modification proposal and its previous proposal in Case No. IPC-E-95-18?

12 A. The most significant differences are the economic climate, its effects on the Company's
13 costs, and the extent of the adverse economic impact that the proposed tariff modification
14 will have.

15 Q. Please explain.

16 A. When the Company proposed its tariff modification in 1995, it was experiencing — and
17 thereafter continued to experience — a period of relatively robust and consistent
18 customer growth. The significant economic downturn being experienced nationally and
19 locally has stunted growth of Idaho Power's commercial and residential customers. In
20 fact, as shown in Table 2, the number of new customers in these two classes has been
21 approximately halved in each of the past two years. Consequently, the asserted
22 increasing "burden" of new growth on the Company's assets now is questionable, even if
23 one were to agree with its assumption that growth is not paying its way. Further, the total
24 cost of new facilities above embedded costs reflects only one percent of the Company's

1 total plant. In other words, it is insignificant in comparison to other factors affecting
2 rates.

3 On the other hand, the serious economic impacts that the Commission found would result
4 from the Company's 1995 Rule H tariff modification are only compounded in the face of
5 the current economic conditions. Particularly for southern Idaho home buyers and the
6 BCA's members who provide the materials and services to build those homes, the
7 increase in the purchase price of a new home that would need to be imposed to recover
8 the cost-shifting proposed by Idaho Power, should be expected to price-out hundreds of
9 potential home buyers.

10 Using a computation methodology endorsed by the National Association of Home
11 Builders ("NAHB") and economic data for the Boise City-Nampa, ID Metropolitan
12 Statistical Area, the BCA estimates that for each additional \$1,000 of cost in the price of
13 a home, an additional 538 households will be "priced-out" or unable to purchase a home.
14 I have attached the NAHB analysis supporting these estimates as Exhibit 203 to my
15 testimony.

16 Q. Does the Company's proposal constitute discrimination against new customers?

17 A. Definitely. While such a policy may or may not be judged unconstitutional, it clearly
18 places the two groups — existing and new customers — in very different positions
19 relative to their cost of energy, without a rational basis for doing so. "New" customers
20 will have paid full marginal cost for their distribution service, while "existing" customers

1 continue to pay depreciated average cost – and, at the same time enjoy the reduced
2 maintenance cost made possible by the newer plant. Put another way, the new customer
3 will be required to fully capitalize his terminal services – without benefit of ownership,
4 while the existing customer leases capital facilities provided by the Company. And of
5 course, the new customer also is required to join the existing customer in paying the cost
6 of the existing system — essentially paying on two fronts for the same service an existing
7 customer receives.

8 Q. Does it matter whether this discrimination is judged constitutional or not?

9 A. Not really. Like the laws of physics, the laws of economics tend to ignore human
10 politics. As shown earlier, customers are not confined to Idaho Power for energy. In
11 making their choices among fuels, they will defeat any attempt to artificially suppress the
12 price of one fuel relative to others. They will move to the cheaper fuel. This fuel
13 switching ability makes expansion of supply (i.e., generation, transmission and
14 distribution) inevitable, regardless of growth.

15 Q. Nevertheless, do you believe that certain modifications to the Company's Rule H tariff
16 would be appropriate?

17 A. Yes, I do, although they are in the direction of increased refunds and allowances to the
18 new customer rather than their elimination, as proposed by the Company.

1 **Reconciling allowances and inflated costs**

2 Q. Do you have a proposal for calculating an appropriate refund?

3 A. Yes. The reason that allowances and refunds fall out of date over time would appear to
4 be inflation. Certainly the Company, in its application and testimony, has provided no
5 other reason, nor have they quantified the presumed disparity.

6 Thus, it is fully appropriate that these costs be kept in line for periods of time between
7 general rate cases, and adjusted at that point to keep the allowances and refunds in a
8 generally consistent relationship with embedded costs.

9 Q. How do you propose to do that?

10 A. To keep the costs aligned with real costs, and to send the correct price signal to
11 customers, allowances and refunds should be indexed annually to an appropriate inflation
12 measure. This could be done as part of the Power Cost Adjustment mechanism, which
13 keeps rates current with fuel prices.

14 One easily available and conservative index is the implicit price deflator for the Gross
15 Domestic Product. Applying this deflator, PGDP, to the 1995 and prior refund
16 allowances of \$800 and \$1200, respectively, yields the following information:

1

Table 1

Year	GDP Implicit price deflator		
	PGDP	Refund \$800	Refund \$1200
1995	0.025	800	1,200
1996	0.037	830	1,244
1997	0.045	867	1,300
1998	0.042	903	1,355
1999	0.045	944	1,416
2000	0.037	979	1,468
2001	0.008	987	1,480
2002	0.016	1,003	1,504
2003	0.025	1,028	1,541
2004	0.036	1,065	1,597
2005	0.029	1,095	1,643
2006	0.028	1,126	1,689
2007	0.02	1,149	1,723
2008	0.013	1,164	1,745

2 Q. What is the current embedded cost?

3 A. The 2008 cost of service study used in IPC-E-08-10 shows distribution rate base per
4 customer of \$1,002 for residential service (Exhibit 204). Thus, the inflation-adjusted
5 refund from IPC-E-95-18 appears to be supported by current embedded costs.

6 Q. How do the per lot costs under the existing Rule H compare with this analysis?

7 A. Given the analysis provided by the Company in response to our production request
8 (Exhibit 202), under the existing Rule H total rate-based costs are \$1,964, \$1,140, and
9 \$1,159 for developments of 3,10, and 32 lots respectively. Under the proposed Rule,
10 those costs fall to \$1,187, \$178, and \$222. The existing Rule shows some consistency as
11 development size increases; the proposed Rule is totally inconsistent between very small

1 and larger developments, and attempts to force the new customer to fully capitalize these
2 costs, contrary to long-standing utility costing principles.

3 Q. What do you recommend?

4 A. For reasons stated above, I recommend the Commission require that terminal facilities be
5 provided and included in rate base, as they were prior to IPC-E-95-18. I further
6 recommend that the per-lot refund for line extensions be raised to \$1000 per lot and
7 indexed to the GDP implicit price deflator, adjusted annually together with the PCA
8 mechanism between general rate cases.

9 Following my earlier analysis, it is wholly appropriate that new plant introduced
10 into rate base be costed at a level slightly higher than current embedded cost, as would be
11 accomplished by adoption of my recommendations. This practice will cause additional
12 plant to be priced at a level comparable to replacement plant, appropriately reflect the
13 economic value of new plant to the system and to all rate payers, and avoid the
14 discrimination inherent in the Company's proposal.

15 Q. Does the Company provide quantitative support for its proposal that terminal facilities
16 plus an allowance be replaced by a flat \$1780 per transformer?

17 A. No, it does not. For that reason, and the reasons stated above, this proposal should be
18 rejected, in favor of the practice prior to the IPC-E-95-18 case.

19 Q. What do you recommend for general overhead?

1 A. Overhead is an extremely difficult area to analyze without a full audit of the Company's
2 operations. I do not have a specific recommendation. There are many areas of the
3 Company's operations that have very little to do with line extensions: general corporate
4 operations, generating and transmission plant, billing and receivables management,
5 power purchases and sales, and others. Engineering is already included at cost; certainly
6 some management, secretarial, office, inventory, and other costs are appropriate. So
7 while the existing overhead rate of 1.5% may be too low, adopting a company-wide rate
8 on an arbitrary basis would appear to be excessive. It would also, pending the next
9 general rate case, cause double collection of those costs.

10 Q. How important is this issue to Idaho Power's other ratepayers? How much pressure do
11 distribution costs from new construction place on rates?

12 A. Not very much, particularly in today's economy. Residential growth has been slowing,
13 falling from a high of 4.0% in 2005 to just under 1% in 2008, making this issue
14 something less than urgent. There were 3,736 new residential customers in 2008.
15 Assuming that each represents a new lot on which an \$800 was refunded, plus
16 approximately \$3000 per transformer, that totals just under \$3 million of new distribution
17 cost, out of \$445 million of residential distribution plant (0.9%), or of \$1.5 billion of total
18 plant (0.27%). In fact, many of the new customers are in high-density apartment blocks,
19 reducing costs significantly. The impact on average retail rates could not be more than
20 \$.06 x .01, or six-tenths of one mill, rather smaller than the 3% inflation experienced in
21 the rest of the economy.

1

Table 2

Idaho Power Residential customers, end of year

	Customers	Added	% growth
1995	281,792	8,596	3.1%
1996	291,116	9,324	3.3%
1997	299,696	8,580	2.9%
1998	308,432	8,736	2.9%
1999	318,896	10,464	3.4%
2000	326,922	8,026	2.5%
2001	335,285	8,363	2.6%
2002	344,447	9,162	2.7%
2003	354,704	10,257	3.0%
2004	366,218	11,514	3.2%
2005	380,952	14,734	4.0%
2006	393,338	12,386	3.3%
2007	400,637	7,299	1.9%
2008	404,373	3,736	0.9%

2

Source: IPCo Response to BCA First Production Request, page 42

3

Q. The Company proposes that to reduce administrative costs the time allowed for vested interest refunds should be reduced from five years to four. Can you support that proposal?

4

5

6

A. No. The Company's proposal would appear to be based on the asserted difficulty of maintaining current addresses for developers beyond a very short time period. To further reduce the period for recovery of vested interests is arbitrary and inappropriately designed for the need.

7

8

9

10

Q. Do you propose an alternative method?

11

A. Yes. In today's economic environment, with growth substantially slowed, the recovery period should not be reduced, but expanded. In my opinion, a ten-year period would

12

1 more appropriately track the connection of new customers with distribution facilities.
2 There is no reason that the Company's accounting cannot track the accounts for that
3 period of time.

4 Q. How do you propose to handle the problem of missing addresses or contact information?

5 A. That burden could be shifted from the Company to the owner of the vested interest. The
6 contract creating the vested interest might simply require the developer or other owner to
7 maintain current contact information with the Company. The Company could then be
8 relieved of its refunding obligation after a reasonable period during which a vested
9 interest owner did not have valid information on file with the Company.

10 Q. Does this complete your testimony?

11 A. Yes, it does.

BEFORE THE
IDAHO PUBLIC UTILITIES COMMISSION
CASE NO. IPC-3-08-22
BUILDING CONTRACTORS ASSOCIATION OF
SOUTHWEST IDAHO

SLAUGHTER, RICHARD

EXHIBIT NO. 201

Cost of Growth Example

Cost of Growth Example

Year →	1		2		3		4		5	
	<u>Inv.</u>	<u>Depr.</u>								
Customer 1	100	25		25		25		25	100	25
Customer 2			100	25		25		25		25
Customer 3					100	25		25		25
Customer 4							100	25		25
Total	100	25	100	50	100	75	100	100	100	100
Average		25		25		25		25		25

Annual investment and depreciation cost for four customers over five years. Investment for each customer is \$100, with a four-year life.

Exhibit 201

Direct Testimony of Richard Slaughter (BCA)
 IPUC Case No. IPC-E-08-22

BEFORE THE
IDAHO PUBLIC UTILITIES COMMISSION
CASE NO. IPC-3-08-22
BUILDING CONTRACTORS ASSOCIATION OF
SOUTHWEST IDAHO

SLAUGHTER, RICHARD

EXHIBIT NO. 202

Comparison of Existing and Proposed
Rule H Cost Distribution

Comparison of Existing and Proposed Rule H Cost Distribution

No. of Lots	Project Cost	Existing Rule H				Proposed Rule H			
		Terminal Facilities Allowance	Maximum Refund	Total Customer	Total Company	Terminal Facilities Allowance	Maximum Refund	Total Customer	Total Company
3	\$10,897	\$3,493	\$2,400	\$5,004	\$5,893	\$3,560	\$0	\$7,337	\$3,560
10	\$19,929	\$3,397	\$8,000	\$8,532	\$11,397	\$1,780	\$0	\$18,149	\$1,780
32	\$50,432	\$11,496	\$25,600	\$13,336	\$37,096	\$7,120	\$0	\$43,312	\$7,120

Source: Idaho Power Company's Response to BCA production request, Page 5

BEFORE THE
IDAHO PUBLIC UTILITIES COMMISSION
CASE NO. IPC-3-08-22
BUILDING CONTRACTORS ASSOCIATION OF
SOUTHWEST IDAHO

SLAUGHTER, RICHARD

EXHIBIT NO. 203

NAHB Calculation of Households Priced Out of a Market

Boise City-Nampa, ID MSA Households that Can Afford to Buy a House When Price Declines

Area	Mortgage Rate	House Price	Monthly Mortgage Payment	Taxes and Insurance	Minimum Income Needed	Households That Can Afford House
Boise City-Nampa, ID MSA	5.00%	\$214,990	\$1,093	\$172	\$54,186	107,374
Boise City-Nampa, ID MSA	5.00%	\$215,990	\$1,098	\$173	\$54,439	106,836
Difference		\$1,000	\$5	\$1	\$252	-538

Calculations assume a 10% down payment and a 45 basis point fee for private mortgage insurance.
 A Household Qualifies for a Mortgage if Mortgage Payments, Taxes, and Insurance are 28% of Income

Boise City-Nampa, ID MSA Household Income Distribution for 2008			
Income Range:		Households	Cumulative
\$0	to \$10,397	11,330	11,330
\$10,398	to \$15,596	11,711	23,041
\$15,597	to \$20,795	9,472	32,513
\$20,796	to \$25,994	13,951	46,464
\$25,995	to \$31,192	15,471	61,935
\$31,193	to \$36,391	13,703	75,637
\$36,392	to \$41,590	13,535	89,173
\$41,591	to \$46,789	11,839	101,012
\$46,790	to \$51,988	11,603	112,615
\$51,989	to \$62,386	22,186	134,801
\$62,387	to \$77,983	25,666	160,466
\$77,984	to \$103,977	26,465	186,931
\$103,978	to \$129,972	14,883	201,814
\$129,973	to \$155,966	7,717	209,531
\$155,967	to \$207,955	7,034	216,565
\$207,956	to More	8,112	224,677

Exhibit 203

Direct Testimony of Richard Slaughter (BCA)
 IPUC Case No. IPC-E-08-22



Determining the Number of Households Priced Out of a Market

The issue of house price changes and their impact on affordability arises in a number of contexts, such as when considering policies that impose fees on new construction. A relatively straightforward approach often used by NAHB to analyze this situation is based on mortgage underwriting standards. Under those standards, it is relatively easy to calculate the number of households that can qualify for a mortgage before an increase in a representative home price, but not afterwards. The difference is the number of households that are 'priced out' of the market for a representative home.

A priced out analysis doesn't answer all possible questions about impacts on housing markets, such as what the differences in home sales or housing starts would be. Although these are important questions, a reasonable attempt to answer them requires estimates of key economic parameters such as the willingness of households to accept homes that are somewhat smaller or have fewer amenities to achieve affordability, the relationships among different segments of the housing market in question, and the adjustments builders make in the products they offer in response to changed affordability conditions on the rise. Good estimates of these parameters are seldom available. In comparison, a priced out analysis that simply shows how many households in an area cross a particular affordability threshold is relatively easy to understand and can be calculated in a straightforward manner using data that are available for any housing market in the U.S.

According to the American Housing Survey (which is financed by HUD and conducted every other year by the U.S. Census Bureau), only about one-fifth of home buyers purchase their homes for cash. Thus, affordability for most prospective buyers is tied tightly to ability to qualify for a mortgage, and mortgage underwriting standards provide a reasonable basis for estimating affordability. Indeed, in the recent economic environment characterized by many financial institutions trying to recover from past errors in judgment, lenders have become very conservative and are more likely than ever to apply conventional underwriting standards with little flexibility.

Standards to qualify for a mortgage are typically expressed as a fraction of prospective buyers' income. One common standard is based on what the industry calls a "front end ratio"—the percentage of income that would be consumed by paying principal and in interest on the mortgage, as well as property taxes and property insurance. The front end ratio can easily be computed for a set of assumptions about the mortgage and household income.

The assumptions NAHB typically uses in "priced-out" computations are a downpayment equal to 10 percent of the purchase price and a 30-year fixed rate mortgage. For a loan with this downpayment, lenders would typically require mortgage insurance, so NAHB also assumes an annual premium of 45 basis points for private mortgage insurance. Local information about property taxes and property insurance per dollar of home value can be computed from the Census Bureau's most recent (2007) American Community Survey (ACS) data.

Detailed 2007 income distributions for all states and metropolitan areas are also available from the ACS. NAHB makes relatively minor adjustments to the ACS income distributions to account for income and population changes that may have occurred since 2007. Dollar boundaries of the income distribution are adjusted based on percentage changes in the median family income estimates that HUD produces annually for all states and metropolitan areas. The number of households in each income bracket is adjusted using the 2006-2007 percentage change in the number of households reported in the ACS, assuming that this household growth rate applies evenly across all income brackets rate in the period after 2007.

BEFORE THE
IDAHO PUBLIC UTILITIES COMMISSION
CASE NO. IPC-3-08-22
BUILDING CONTRACTORS ASSOCIATION OF
SOUTHWEST IDAHO

SLAUGHTER, RICHARD

EXHIBIT NO. 204

**Idaho Power Company's Allocation of
Distribution Rate Base**

Idaho Power Company
Allocation of Distribution Rate Base
Case No. IPC-E-08-10*
2008 Test Year

	Residential Service (1)	Small General Service (7)	Large General Service Primary (9-F)	Large General Service Secondary (9-S)
RATE BASE - DISTRIBUTION				
Substations - General	\$ 63,364,339	\$ 2,253,911	\$ 3,636,415	\$ 31,570,148
Lines - Primary	138,827,398	8,118,342	3,829,647	37,948,817
Line Transformers - Primary	21,737,910	1,273,022	600,520	5,950,665
Line Transformers - Secondary	94,563,927	5,400,665	2,334,795	27,226,347
Lines - Secondary	38,379,046	2,079,803	1,809,641	12,144,140
Services	13,967,295	1,216,145	26,362	1,184,110
Meters	21,834,424	3,839,118	780,798	11,800,537
Street Lights	-	-	4,057	-
Other Installations at Customers' Premises	-	-	2	-
Total	\$ 392,474,339	\$ 24,181,006	\$ 13,022,237	\$ 127,824,765
Average Number of Customers	391,525	31,171	146	26,702
Distribution Rate Base per Customer ^a	\$ 1,002	\$ 776	\$ 89,193	\$ 4,787

Notes:

- (a) Distribution-related rate base values can be found on Exhibit No. 65, page 1 of 6, Case No. IPC-E-08-10.
- (b) Customer numbers can be found on Exhibit No. 76, page 1 of 1, Case No. IPC-E-08-10.

CERTIFICATE OF SERVICE

I hereby certify that on the 17th day of April, 2009, a true and correct copy of the foregoing was served upon the following individual(s) by the means indicated:

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