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IDAHO PUBLIC  
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF IDAHO POWER )  
COMPANY'S APPLICATION FOR A ) CASE NO. IPC-E-09-03  
CERTIFICATE OF PUBLIC CONVENIENCE )  
AND NECESSITY FOR THE LANGLEY )  
GULCH POWER PLANT. )  
\_\_\_\_\_ )

IDAHO POWER COMPANY

DIRECT TESTIMONY

OF

LORI SMITH

1 Q. Would you please state your name, business  
2 address, and present occupation?

3 A. My name is Lori Smith and my business  
4 address is 1221 West Idaho Street, Boise, Idaho. I am  
5 employed by Idaho Power Company ("Idaho Power" or  
6 "Company") as Vice President of Corporate Planning and  
7 Chief Risk Officer.

8 Q. What is your educational background?

9 A. I graduated in 1983 from Boise State  
10 University, Boise, Idaho, receiving a Bachelor of Business  
11 Administration degree in Information Sciences. In 1999, I  
12 was awarded the designation of Chartered Financial Analyst.  
13 In 2008, I completed a two-part course in Decision Analysis  
14 and Decision Quality in Organizations at the Stanford  
15 Center for Professional Development. I have also attended  
16 numerous seminars and conferences related to utility  
17 accounting, corporate finance, and risk related topics.

18 Q. Would you please outline your business  
19 experience?

20 A. From 1983 to 1986, I was employed by Idaho  
21 Power Company and assigned to the Materials Management  
22 Department. From 1986 to 1994, I served as a Financial  
23 Accountant and later as a Budget Accountant. I was  
24 promoted to Business Analyst in 1994. In 1996, I was

1 promoted to Strategic Analysis Team Leader. In 2000, I  
2 assumed the position of Director of Strategic Analysis. In  
3 2003, I was named Director of Strategic Analysis and Risk  
4 Management. In 2004, I was promoted to the position of  
5 Vice President of Finance and Chief Risk Officer. In 2008,  
6 I assumed my current position as Vice President of  
7 Corporate Planning and Chief Risk Officer.

8 Q. What are your duties as Vice President of  
9 Corporate Planning and Chief Risk Officer?

10 A. My responsibilities include the oversight of  
11 corporate development, strategic planning, and risk  
12 management processes for Idaho Power Company. Corporate  
13 development includes acquisitions, divestitures, and joint-  
14 ventures. Strategic planning includes development of  
15 analyses, strategies, and operating plans. Risk management  
16 includes activities related to managing market, credit, and  
17 operational risk exposure from an enterprise perspective.

18 I am tasked with ensuring the best use of Idaho  
19 Power's resources by defining and planning the Company's  
20 strategic and long-range goals. I am also responsible for  
21 the analysis of the financial impacts of regulatory  
22 strategy to ensure successful implementation and provide  
23 meaningful insight into strategic alignment. I direct the  
24 development of operational forecasts and analysis both

1 long- and short-term. In addition, I am the corporate  
2 board representative for Ida-West Energy and IDACORP  
3 Financial Services. I have subsidiary leadership  
4 responsibilities that include setting goals and defining  
5 investment criteria and performance requirements. I direct  
6 the activities related to the organization's market risk  
7 and credit exposure to protect against adverse movements in  
8 net power supply costs. Finally, I am responsible for  
9 designing, developing, and implementing an Enterprise Risk  
10 Management process for IDACORP, Inc., and Idaho Power  
11 Company.

12 Q. What is the purpose of your testimony in  
13 this proceeding?

14 A. I describe how Idaho Power's need for  
15 capital to fund infrastructure and maintenance investments  
16 over the next three years exceeds the cash flow it receives  
17 from operations. It will be very difficult for Idaho Power  
18 to finance the Langley Gulch power plant with debt or  
19 equity given the current conditions in the capital markets,  
20 the restructuring of which has resulted in limited  
21 availability of credit and devalued stock prices. Given  
22 these adverse economic conditions, I believe the proposed  
23 recovery of CWIP in rate base annually or the regulatory  
24 ratemaking assurances described in Mr. Ric Gale's testimony

1 will minimize Idaho Power's need to access the capital  
2 markets and/or make the Company more attractive to lenders  
3 if it does.

4 IDAHO POWER'S NEED FOR ADDITIONAL CAPITAL

5 Q. What is Idaho Power's current ability to  
6 fund plant investments required to meet its customers'  
7 energy needs over the next three years?

8 A. Idaho Power has been diligent in its efforts  
9 to continue to meet the energy needs of its customers.  
10 This has been demonstrated in the Company's Integrated  
11 Resource Plan ("IRP"), the most recent of which was filed  
12 in 2006 and updated in June 2008. The IRP has identified  
13 the need for a baseload resource to come on-line in 2012.  
14 As Mr. Karl Bokenkamp describes in his testimony, the 330  
15 MW Langley Gulch power plant project ("Project") identified  
16 through the competitive bidding process will meet the  
17 growing customer demand for electricity in 2012. However,  
18 the expenditures associated with this Project combined with  
19 the continued needs to upgrade existing facilities, expand  
20 environmental controls, and maintain an aging  
21 infrastructure, require the Company to expend a significant  
22 amount of capital in order to meet these needs.

23 These capital requirements come at a time when the  
24 Company's balance sheet has been weakened due to the

1 impacts of drought conditions in six of the last seven  
2 years and much higher historical capital expenditures since  
3 2006 to meet the demands of customer growth. The cost of  
4 the new infrastructure, to be built concurrently with  
5 current maintenance capital expenditures, substantially  
6 exceeds Idaho Power's cash flow from operations.

7 Q. What is cash flow from operations?

8 A. A simple measure of cash flow from  
9 operations is seen in the average of depreciation expense  
10 plus net operating income, a proxy for cash flow from  
11 operations. During the time period 2006 through 2008,  
12 Idaho Power Company generated on average approximately \$190  
13 million of cash flow from operations. The average of  
14 construction expenditures during this time was \$250  
15 million. The shortage of internally generated cash flows  
16 versus Idaho Power's infrastructure investments, on  
17 average, from 2006-2008 is \$60 million per year. The  
18 additional construction expenditures above cash flow from  
19 operations must be acquired from the capital markets in a  
20 balanced combination of long-term debt financing and  
21 issuances of common stock.

22 Q. What is the impact of inadequate cash flows?

23 A. Inadequate cash flows cause credit rating  
24 agencies to be concerned. The credit rating community uses

1 cash flow and other financial ratios with more subjective  
2 evaluations, such as perceived regulatory support, to  
3 assess the financial health and prospects for a utility.  
4 If changes in such measures exceed a rating agency's  
5 thresholds, such changes can affect bond ratings. Bond  
6 ratings, in turn, directly affect both the cost and the  
7 availability of debt, which are both important components  
8 in determining the utility cost of capital.

9 Q. How much capital does the Company expect to  
10 invest in its system over the next three years?

11 A. As reported on February 26, 2009, in  
12 IDACORP's and Idaho Power's FORM 10-K, the Company expects  
13 to spend between \$220 and \$230 million in 2009 and average  
14 from \$278 million to \$295 million between 2010 and 2011  
15 **excluding** the investment in the 2012 Langley Gulch Project.  
16 The expected investment requirements to reliably maintain  
17 and operate the system impose additional pressure on cash  
18 flow coverage ratios during the next three years absent a  
19 significant increase in operating cash flows.

20 Q. What is the impact of this shortage of cash  
21 flow from operations?

22 A. The shortage must be financed with funds  
23 raised in the capital markets. The Company must acquire  
24 long-term debt and have the ability to issue common stock

1 in order to make the required investments related to  
2 providing reliable service. Given the current state of the  
3 capital markets, Idaho Power has limited ability to access  
4 the capital it needs to finance construction of the Langley  
5 Gulch Project and cannot predict when the market may return  
6 to "normal."

7 **CURRENT STATE OF THE CAPITAL MARKETS**

8 Q. What is the current state of the capital  
9 markets?

10 A. The current credit crisis in the capital  
11 markets can be characterized by significant credit  
12 contraction as a result of the fundamental restructuring of  
13 the financial sector. This restructuring is evidenced by  
14 fewer banks, increased regulatory requirements for capital  
15 adequacy, and significant new requirements to de-leverage  
16 bank balance sheets from their historical leverage  
17 multiples of up to 30 times. Since Labor Day 2008, there  
18 have been unprecedented market events from the credit  
19 contraction, including the U.S. Treasury's efforts to  
20 stabilize the U.S. banking industry by providing \$350  
21 billion through the Troubled Asset Relief Program ("TARP").  
22 The U.S. Treasury's critical objectives are to stabilize  
23 the financial markets and reduce systemic risk, support the  
24 housing market by avoiding preventable foreclosures and



1 facilitate mortgage finance, and to protect taxpayers. To  
2 this end, the U.S. Treasury has thus far allocated a total  
3 of \$700 billion in the Emergency Economic Stabilization  
4 Act, including the TARP funding.

5 Idaho Power has long-term banking relationships, a  
6 high percentage of which are with banks that have received  
7 TARP funding from the U.S. Treasury. These relationships  
8 are in good working order; however, it is unknown whether  
9 the market will be receptive to the Company's financing  
10 needs when Idaho Power is ready to access the capital  
11 markets. This access to capital markets cannot be  
12 predicted at this time. The collapse of the credit markets  
13 reduced the number of banks providing liquidity as a result  
14 of bank failures, government interventions, and Mega  
15 mergers. The result is increased volatility, increased de-  
16 leveraging, and de-risking by the U.S. banking industry.

17 Q. Why is access to the capital markets so  
18 important to this proceeding?

19 A. Idaho Power cannot internally fund the  
20 required investment in plant, including the Langley Gulch  
21 Project, necessary to reliably serve customers from its  
22 existing operations. The impact of this crisis  
23 significantly increases the value of an investment grade  
24 credit rating as the lending capacity of the financial

1 industry contracts and the selection criteria for borrowing  
2 companies is more stringent. It is critical that our  
3 continued efforts to maintain Idaho Power's corporate  
4 credit rating of BBB with S&P and Baal with Moody's are  
5 successful.

6 Q. Why is Idaho Power's ability to maintain its  
7 credit rating paramount in this uncertain credit  
8 environment?

9 A. Maintaining our current credit rating  
10 minimizes the interest rate spread between different rating  
11 grades (investment grade versus below investment grade) and  
12 allows the Company to access long-term maturities of debt.  
13 The alternative would be to finance long-lived assets with  
14 short-term duration bonds that subject our customers to  
15 interest rate risk in the form of durations for bonds that  
16 do not match the life of the asset.

17 For investment grade issuers, like Idaho Power, the  
18 credit spreads (i.e., the yield spread, or difference in  
19 yield between different securities due to different credit  
20 quality) for issuers were at an all time low in 2005. This  
21 relatively inexpensive liquidity and ability to access  
22 long-term capital changed in October 2008 to a capital  
23 market with short supply, with liquidity being non-existent  
24 or very hard to obtain. The cost of funding across the

1 capital structure increased for short-term and long-term  
2 debt and the reduction in stock market values decreased the  
3 overall ability to raise capital. Some companies that  
4 currently have a credit rating below investment grade have  
5 experienced complete exclusion from the market place from  
6 October 30 through December 9, the longest period without  
7 new issuance in 17 years. Additionally, issuers are  
8 reluctant to launch a transaction without a high degree of  
9 certainty around its success because of the negative  
10 publicity associated with failed transactions. The  
11 increase in credit spreads as a result of the rapid  
12 deterioration in the U.S. banking industry and corporate  
13 credit markets brought a historic wholesale widening of  
14 credit spreads and a slowdown in supply of credit to high-  
15 grade issuers. The market access to BBB issuers, like  
16 Idaho Power, has improved but access still remains credit  
17 specific, volatile, and unpredictable.

18           The Company's access to credit at reasonable costs,  
19 desired maturity of issue, and reasonable financing terms  
20 is greatly dependent on the investment grade rating  
21 currently in place.

22           Q.       How do major credit rating agencies  
23 determine Idaho Power's credit profile?

1           A.       The credit rating agencies begin their  
2 assessment using a variety of financial ratios. The  
3 calculation of these ratios varies between credit rating  
4 agencies. In addition, the credit rating agencies evaluate  
5 certain qualitative factors, including the regulatory  
6 environment, management capability, and past operational  
7 and financial performance. Please see Exhibit No. 5 for  
8 the most recent Moody's and S&P publications on Idaho Power  
9 Company.

10           Q.       In the event the Commission selected a  
11 different alternative to the Project, do credit rating  
12 agencies view credit risk for purchase power agreements or  
13 tolling agreements differently than a plant built by a  
14 utility?

15           A.       No. When a company decides to buy  
16 generation thru a long-term purchase power agreement or a  
17 tolling arrangement there is a risk transfer from the  
18 seller of the energy to the buyer of the energy and its  
19 customers and shareholders in the form of imputed debt.  
20 Imputed debt is a measure of financial risk shifted to a  
21 utility when it enters into a purchase power agreement  
22 ("PPA") or tolling agreement ("TA"). The imputed debt  
23 measurement is calculated by S&P, for example, and included  
24 in the analysis of financial ratios used to measure the

1 utility's creditworthiness. Because debt, actual or  
2 imputed, is attributed to the utility that acquires power  
3 through the construction of a new plant, PPA or TA,  
4 regulatory support is needed to mitigate the impact on the  
5 utility's financial ratios. The mitigation can take the  
6 following forms:

7                   1. Full and automatic regulatory support  
8 which can reduce the financial risk imposed on a utility  
9 from imputed debt by decreasing or eliminating the  
10 uncertainty regarding full recovery of the costs of the  
11 PPA.

12                   2. Compensate the utility for the  
13 increased financial risk by

14                   a. Increasing the amount of equity in  
15 the rate base, and/or

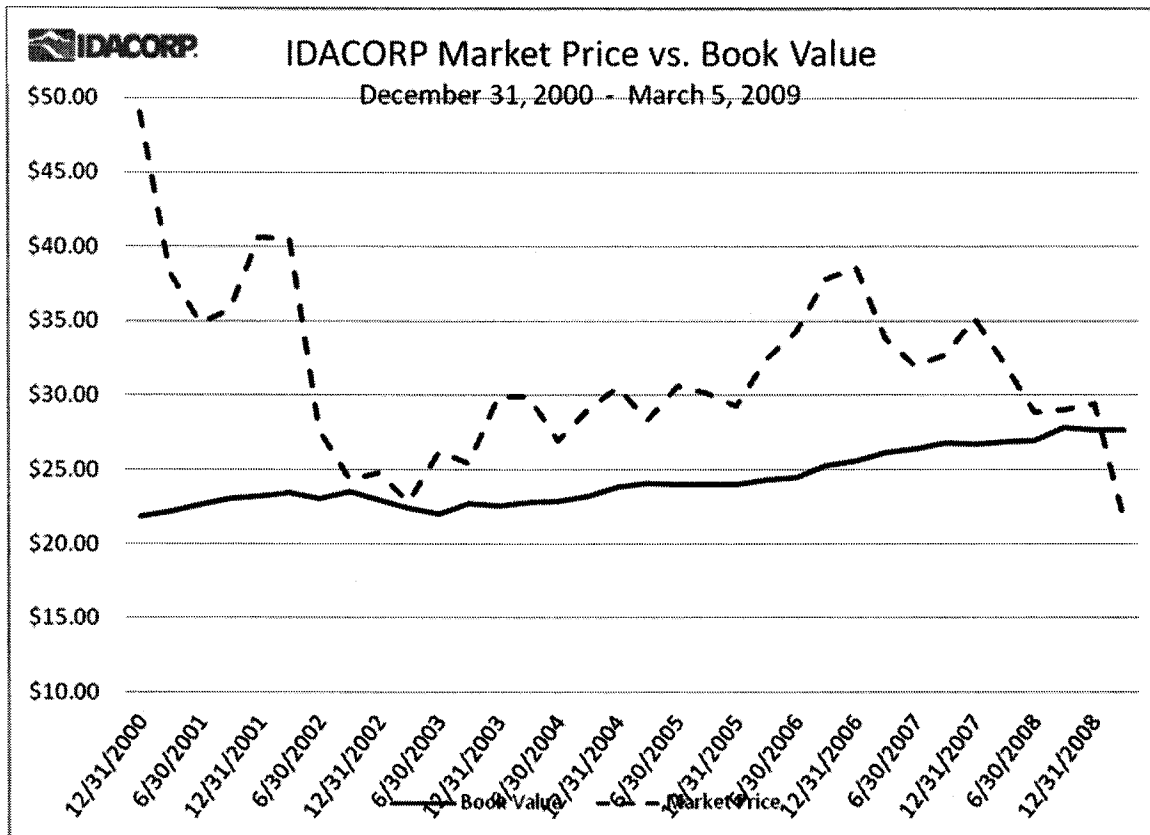
16                   b. Increasing the allowed return on  
17 equity, and/or

18                   c. Restoring financial ratios to pre-  
19 PPA or TA level with an adder to the PPA payment.

20           To further explain the ramifications of imputed debt  
21 on utilities, I have included a white paper written by the  
22 Brattle Group for the Edison Electric Institute and  
23 regulatory staff called "Understanding Debt Imputation  
24 Issues" as Exhibit No. 6.

1           Q.           What are the risks of issuing common stock  
2 during times when the market value of the stock is below  
3 its book value, as Idaho Power's stock currently is?

4           A.           The Company's stock has deteriorated in  
5 value by 25.4 percent from December 2008 to March 5, 2009.  
6 The Company has not seen a decline of this magnitude since  
7 late 2000 in which IDACORP's telecommunications and energy  
8 marketing affiliates helped drive down IDACORP's stock  
9 price. Evidenced below is a chart of IDACORP's trading  
10 history since the end of 2000. The market value of  
11 IDACORP's stock is trading below book value at a time when  
12 the Company needs to raise capital to finance the  
13 construction of the Project. A corporation's book value is  
14 used in fundamental financial analysis to help determine  
15 whether the market value of corporate shares is above or  
16 below the book value of corporate shares. Issuing new  
17 equity below book value will cause dilution of existing  
18 shareholders and invites shareholder lawsuits.



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**RELIEF REQUESTED**

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Q. Mr. Gale's testimony describes the Company's ratemaking request in the form of two alternatives: (1) recovery of a portion of Construction Work in Progress ("CWIP") the Company incurs as it constructs the Project to be included in current rates on an annual basis or (2) explicit findings on how the Commission intends to treat the Company's Langley Gulch investment for ratemaking purposes at the time it is placed in service. How would the financial community view each of these alternatives?

A. The Project is expected to take four years to construct and require significant funding from the

1 capital markets in terms of both debt and equity at a time  
2 of substantial uncertainty related to accessing the capital  
3 markets. CWIP, including AFUDC, in rate base during  
4 construction will provide cash flow to construct the  
5 Project. This new cash flow will reduce the Company's need  
6 to access the capital market at a time of great volatility  
7 and unpredictable access.

8           It is my belief that financing the construction of  
9 the Project without regulatory assurance of rate recovery  
10 or CWIP in rate base will endanger Idaho Power's ability to  
11 maintain its current credit ratings. CWIP in rate base  
12 would be a substantial benefit from a credit perspective  
13 because cash would be collected currently versus the  
14 assurance of cash collected in the future.

15           Q.       If the Commission approves AFUDC and CWIP in  
16 rate base, how does Idaho Power envision these accounts  
17 would operate?

18           A.       AFUDC is the capitalization costs associated  
19 with the construction of an asset, whereas CWIP is the  
20 accumulation of all costs associated with the construction  
21 of an asset plus the cost of financing the construction  
22 expenditures. AFUDC provides for the financial carrying  
23 costs of an asset while it is being constructed and is  
24 recorded in Account 107. During construction, AFUDC is a



1 non-cash entry to Account 107 that represents the costs of  
2 debt financing and an equity return as proscribed in the  
3 FERC formula (CFR 18, Part 101, Subchapter C, Electric  
4 Plant Instruction 3 (A) (17), as amended by a FERC letter  
5 dated December 30, 1981). The AFUDC plus the accumulation  
6 of all other costs associated with construction is then  
7 closed to plant Account 101 as an asset upon completion of  
8 the project.

9           Once included in rate base, AFUDC is typically  
10 recovered over the life of the asset through depreciation  
11 expense and a return on investment earned. The asset and  
12 AFUDC generate cash flow for the Company when included in  
13 rate base in a revenue requirement proceeding.

14           Q.       What benefit would the ratemaking assurances  
15 and CWIP recovery mechanisms provide to Idaho Power  
16 customers?

17           A.       With CWIP, customers will help fund  
18 construction of the Langley Gulch power plant as it is  
19 built, thus avoiding financing costs that would otherwise  
20 be depreciated over several decades. As with buying  
21 furniture or a vehicle, paying for a power plant upfront  
22 with cash is significantly less expensive than financing it  
23 through debt or equity.

1 CWIP in rate base reduces the rate shock experienced  
2 by our customers by smoothing the rate increases over the  
3 construction period versus a one-time large increase at the  
4 end of the construction period. I will describe for  
5 illustrative purposes an example that estimates the  
6 customer impact of three recovery alternatives.

7 In Exhibit No. 7 I have compared two of the  
8 alternative rate recovery examples to a traditional plant  
9 closing to a plant filing of the Langley Gulch power plant,  
10 with ratemaking assurances described in Mr. Gale's  
11 testimony resulting in a rate increase of 7.9 percent over  
12 current rates in early 2013. The first comparison example,  
13 "AFUDC: Pay Currently," is similar to Hells Canyon  
14 Relicensing AFUDC granted in Order No. 30722. If customers  
15 pay currently for AFUDC from 2010 to 2013, the cumulative  
16 increase at the end of construction period would be 6.9  
17 percent, comprised of a 1.9 percent, 1.9 percent, 1.1  
18 percent, and 2.0 percent increase for the years 2010, 2011,  
19 2012, and 2013, respectively. The key difference between  
20 this method and the "CWIP Rate Base" method is that a  
21 regulatory liability is established to collect and amortize  
22 the collection over the life of the plant.

23 In the second example, "CWIP in Rate Base,"  
24 customers paying for all CWIP expenditures including AFUDC

1 would experience an estimated increase of 7.0 percent. The  
2 CWIP in Rate Base example is comprised of a 1.9 percent,  
3 2.0 percent, 1.4 percent, and 1.8 percent rate increase in  
4 the years 2010, 2011, 2012, and 2013, respectively. These  
5 examples demonstrate how the rate increases will be  
6 softened and will allow customers time to adjust to the  
7 increasing rates versus a one-time rate increase that is  
8 preliminarily estimated to be 7.9 percent over current  
9 rates beginning in 2013.

10 Q. Will the inclusion of CWIP in rate base or  
11 ratemaking assurances guarantee access to the debt and  
12 equity capital markets?

13 A. Answering this question with any specific  
14 level of certainty is made more difficult in the current  
15 climate of unprecedented bank failures, the speed of the  
16 economic downturn, continued capital market uncertainty the  
17 contraction of available financing capacity which has  
18 shrunk the once liquid and deep capital markets that Idaho  
19 Power has been able to access in the past. However, I  
20 believe the granting CWIP for all or a portion of the  
21 Company costs for construction of Langley Gulch and  
22 ratemaking assurances as described by Mr. Gale in his  
23 testimony are the kinds of regulatory support mechanisms  
24 that will help to differentiate Idaho Power from other

1 capital-seeking companies when the construction and  
2 permanent financing of the Project is required.

3 Q. Does this conclude your direct testimony in  
4 this case?

5 A. Yes, it does.

**BEFORE THE**  
**IDAHO PUBLIC UTILITIES COMMISSION**

**CASE NO. IPC-E-09-03**

**IDAHO POWER COMPANY**

**SMITH, DI**  
**TESTIMONY**

**EXHIBIT NO. 5**



Credit Opinion: Idaho Power Company

Idaho Power Company

Boise, Idaho, United States

Ratings

Category	Moody's Rating
Outlook	Negative
Issuer Rating	Baa1
First Mortgage Bonds	A3
Senior Secured	A3
Sr Unsec Bank Credit Facility	Baa1
Senior Unsecured Shelf	(P)Baa1
Commercial Paper	P-2
<b>Parent: IDACORP, Inc.</b>	
Outlook	Negative
Issuer Rating	Baa2
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured MTN	Baa2
Commercial Paper	P-2

Contacts

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Key Indicators

[1]

**Idaho Power Company**

	LTM 1Q 08	2007	2006	2005
(CFO Pre-W/C + Interest) / Interest Expense	2.3	2.4	3.3	3.4
(CFO Pre-W/C) / Debt	7%	7%	13%	13%
(CFO Pre-W/C - Dividends) / Debt	3%	3%	8%	8%
(CFO Pre-W/C - Dividends) / Capex	13%	14%	41%	42%
Debt / Book Capitalization	46%	45%	42%	41%
EBITA Margin %	18%	19%	20%	17%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

**Company Profile**

Idaho Power Company (IPC) is a vertically integrated regulated investor-owned utility and the principal wholly-owned subsidiary of IDACORP, Inc. (IDA), a holding company which also serves as parent for other modest-sized non-utility businesses. As an all-electric utility, IPC provides retail electric service to approximately 483,000 residential, irrigation, commercial and industrial customers within a 24,000-square mile service area encompassing southwestern Idaho and eastern Oregon. The company operates a system with 4,747 miles of transmission lines and 26,394 miles of distribution lines. IPC relies heavily on hydro-electric power for its generating needs, normally generating nearly half of the electricity it sells from 17 hydro-electric developments on the Snake River and its

tributaries. IPC also serves a portion of its electric load from three coal-fired power plants in Wyoming, Nevada, and Oregon and from the natural gas-fired Bennett Mountain Power Plant, Danskin 1 Power Plant, and Evander Andrews Power Complex in Mountain Home, Idaho. IPC is the parent of Idaho Energy Resources Co., a joint venture partner in Bridger Coal Company, which supplies coal to the Jim Bridger generating plant owned in part by IPC. The utility also buys electricity from the regional wholesale market to meet its customers' needs for electricity.

On a stand-alone basis, IPC represents the substantial majority of IDACORP's consolidated revenues, net income, and assets. IPC's customers have been weighted toward the residential class, with about 46.1% of 2007 general business revenues derived from sales to residential customers, which are typically more predictable and stable sources of revenue. We do not expect this to change materially in the foreseeable future. The remainder of IPC's 2007 revenues were derived from electricity sales to commercial customers (25.4%), industrial customers (15.2%), and irrigation customers (13.3%).

IPC's retail rates are subject to the regulatory jurisdiction of the Idaho Public Utilities Commission (IPUC) and the Oregon Public Utility Commission (OPUC) as it relates to rates charged to its retail customers and various financing activity. Wholesale activities and interstate activities are subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC).

#### Recent Events

Effective June 3, 2008, Moody's affirmed the ratings of IDACORP, Inc. (Baa2 Issuer Rating and Prime-2 short term debt rating) and its regulated utility subsidiary, Idaho Power Company (IPC; Baa1 senior unsecured and Prime-2 short-term debt rating). At the same time, Moody's changed the rating outlook to negative from stable for both companies. See Press Release of June 3, 2008 for additional commentary.

#### Rating Rationale

Key factors affecting IPC's Baa1 senior unsecured debt rating include a relatively low business risk profile and low cost structure relative to national peers within a usually generally supportive regulatory environment combined with an increasing level of capital expenditures to add generation capacity, transmission infrastructure, and address other asset maintenance to ensure meeting service safety and reliability standards. The company's recent financial metrics, including its coverage of interest and debt by cash flow from operations exclusive of working capital changes (CFO Pre-W/C), have been pressured to a level we often see for a regulated electric utility in the Ba rating category. These recent metrics are the result of unfavorable hydro conditions and the adverse effects the recent increase to the load growth adjustment rate (LGAR) has had on net power supply cost recovery under the power cost adjustment (PCA) mechanism. With respect to the latter concern, we note that the LGAR subtracts the cost of serving additional Idaho retail load from the net power supply costs that IPC is allowed to include in its annual PCA filing. We address the LGAR in more detail below; however, as IPC continues to diversify its resource portfolio and works with the IPUC to adjust or replace the current LGAR, as called for as part of the settlement of the utility's last general rate case, we are concerned about whether recent revenue increases approved by the IPUC and the OPUC, when combined with the likely implementation of further general rate increases associated with future rate filings, will be sufficient to allow IPC's cash flow coverage metrics to revert back to levels more consistent with the current rating over the next 12 to 18 months. Meanwhile, IPC's Integrated Resource Plan (IRP), and its access to sufficient liquidity are considered in line with the Baa rating category. IPC's ratings also take into account that IPC's retail rates remain below national averages, and that it is pursuing strategies to control operating expenses and conservatively finance its investments.

The most important drivers of IPC's current ratings and outlook are as follows:

#### DETERIORATION IN HYDRO CONDITIONS RAISES OPERATING CHALLENGES AND PRESSURES MARGINS

During 2007, there was a return to the drought conditions that have persisted in Idaho in all but one of the last seven years. The one exception was in 2006, when there was a brief normalization of water levels. Inflows into the company's largest storage reservoir, the Brownlee Reservoir, were only 2.8 million acre feet (maf) during the critical April through July 2007 runoff period, which was about 44% of average. Although hydro conditions are somewhat better to date in 2008, they still remain below normal. The current expectations for runoff during the critical April through July period in 2008 of about 4.8 maf is still only about 76% of average. Based on this data, IPC is currently expecting to generate between 6.0 and 8.0 million megawatt hours (MWh) from its hydroelectric facilities during 2008, compared to 6.2 million MWh in 2007. The water conditions in the Snake River Basin this year have enabled IPC's hydro-electric generation to contribute about 46% of total system generation during the first quarter, compared to about 51% for the same period in 2007. When IPC experiences poor hydro-electric generating conditions, it results in a heavier dependence on typically more expensive thermal generation and purchased power, and reduces wholesale sales while increasing operations and maintenance expenses and pressuring margins.

It remains to be seen whether the drought conditions that have persisted for six out of the last seven years in the U.S. Pacific northwest region may be viewed as an anomaly or as part of a larger more permanent or semi-permanent climate shift that signals the need for reduced reliance upon hydro-electric generation for a company such as IPC that has relied fairly extensively upon hydro as the primary component of its generation portfolio. Moody's ratings and negative outlook for IPC take into account these increased operating challenges.

