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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

**IN THE MATTER OF THE APPLICATION OF)
IDAHO POWER COMPANY FOR AUTHORITY) CASE NO. IPC-E-09-28
TO CONVERT SCHEDULE 54 – FIXED COST)
ADJUSTMENT – FROM A PILOT SCHEDULE) COMMENTS OF THE
TO AN ONGOING PERMANENT SCHEDULE.) COMMISSION STAFF
)**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Weldon B. Stutzman, Deputy Attorney General, and in response to the Notice of Modified Procedure issued in Order No. 31010 on February 23, 2010, submits the following comments.

BACKGROUND

On October 1, 2009, Idaho Power Company (IPC, Company) filed an Application requesting an Order authorizing the Company to convert its current Schedule 54 – Fixed Cost Adjustment (FCA, Pilot) – from a pilot schedule to an ongoing, permanent schedule. In Order No. 30267 issued March 12, 2007, the Commission approved implementation of a three-year FCA pilot program for residential service and small general service customers. The FCA mechanism allows Idaho Power to separate collection of fixed costs from volumetric energy sales. A surcharge or customer credit is applied when fixed-cost recovery per customer varies

from a Commission-established base. During the first two years of the pilot program, the FCA true-up resulted in a refund in one year and a surcharge in the next.

Because utilities recover a large portion of their fixed costs through sales of kilowatt-hours of energy, the Company contends that traditional rate design discourages utilities from reducing their sales volume caused by investing in energy efficiency programs. Idaho Power alleges the purpose of the FCA pilot program “was to test the FCA mechanism to determine its efficacy in removing the unintended rate design disincentive for the Company to aggressively pursue DSM programs.” Application, p. 4. Idaho Power asserts that so far during the three-year pilot program the Company has made “strong progress in improving and enhancing its efforts to promote energy efficiency and demand-side management activities.” Application, p. 3. The Company credits this effort “in no small part to removal of the disincentive provided by the FCA mechanism during the term of the FCA pilot.” *Id.*

The Company’s Application requests that the FCA continue to be applicable only to residential and small general service customer classes. During the first two years of the pilot program, the FCA balances for both classes were combined and the same FCA rate adjustment applied to both classes. Idaho Power requests, if the FCA is made permanent, that the FCA balances and annual rate adjustment amounts for each class remain separate so that each class is assigned its own fixed-cost adjustment rate.

STAFF ANALYSIS

Staff does not advocate termination of the FCA, but believes it is premature to convert the FCA from a pilot schedule to a permanent schedule. The following comments detail Staff’s assessment of the pilot period, describe Staff’s concerns in promoting the Pilot to permanent program status, and presents Staff’s recommendations for continuing the FCA in a pilot status for an additional two years.

Observations from the FCA Pilot Program

Staff originally supported the FCA pilot mechanism recognizing that DSM reduces recovery of prudently incurred fixed costs approved for recovery by the Commission. Just as fixed costs are primarily recovered through the energy rate, reduction in energy consumption due to DSM reduces that recovery. Staff agreed that this creates a financial disincentive for the Company to pursue DSM resources that are deemed to be more cost effective than available supply side alternatives. Therefore, the “decoupling” mechanism was put in place to separate the

collection of fixed costs from volumetric energy sales. The FCA works as follows: if the average energy use per customer increases, the Company collects more fixed costs per customer than authorized by the Commission and customers receive a credit; if the average energy use per customer decreases, the Company collects less fixed costs per customer than authorized by the Commission and customers receive a surcharge through the FCA.

During the 2007 FCA period, sales per residential customers increased while sales per small commercial customers declined. This produced a first year credit to residential customers of nearly \$3.5 million, representing a 1.2% decrease in residential rates. Conversely, small commercial customers faced a 7.3% increase due to an under collection of nearly \$1.2 million in fixed cost. However, the fixed cost allocation for the residential and small commercial classes the Company used to establish proposed FCA rates for the 2007/2008 period was not based on a Commission-approved cost of service study as required by the FCA Stipulation. Instead, it was based on a Commission-approved revenue requirement from a settled 2005 rate case and a Company-proposed cost of service model. Staff noted that without a Commission-approved cost of service model, there is “no confirmation of what the Commission deems to be ‘authorized’ fixed costs.” *See* Case No. IPC-E-08-04, Staff Comments, p. 5. Staff recommended that the FCA deferral balances for the two customer classes be merged and a single blended FCA credit be returned to each customer class. The Company and Commission agreed, and the result was a 0.045676 ¢/kWh reduction in residential and small commercial rates. *See* Order No. 30556.

The second year of the FCA Pilot saw a decrease in per-customer usage for both the residential and small commercial classes. This alone led to an under-recovery of authorized fixed costs. In addition, a general rate increase led to a higher fixed cost per customer (FCC) and fixed cost per energy (FCE), further increasing the lost fixed cost recovery associated with reduced energy sales. For the most part, the issues raised in the first year concerning the variables used to set FCA rates had been adequately addressed. The result in the second year was a net under-recovery of \$2.7 million in fixed costs. All parties supported instituting a blended FCA surcharge to be applied evenly to both affected customer classes. Staff believed a blended rate was appropriate because while the effect on residential customer bills would be negligible, the impact to small commercial would be quite large.¹ *See* Case No. IPC-E-09-06, p. 5. IPC and Staff also noted that a blended rate was consistent with the Commission’s Order

¹ Without the 3% cap, small commercial customers would have seen a surcharge of 10.3%.

the prior year. In Order No. 30827, the Commission approved a surcharge of 0.0529 ¢/kWh for all residential and small commercial customers.

The Company filed its FCA rates for the final year of the Pilot on March 16, 2010. *See* Case No. IPC-E-10-07. The Company contends that use per customer continued to decline for both the residential and small commercial classes relative to the 2008 test year. Residential customers in particular may face a doubling of the surcharge currently in place. The Company's application indicates that for the third consecutive year the small commercial class has a deferral balance that exceeds the 3% cap put in place by the Commission. IPC advocates blending the deferral balances, as in the prior two years, resulting in a 1.85% increase to rates for each class. Staff has not completed its review of the Company filing, nor has the Commission issued a final Order in the Case.

From a purely mechanical standpoint, the FCA has worked as intended - i.e., when sales per customer have declined, the FCA has resulted in a customer surcharge and when sales per customer have increased, a credit was returned. Given the significant departure from traditional ratemaking methodology, the pilot program has provided an opportunity to both Staff and the Company to further understand the merits and mechanics of decoupling mechanisms.

Staff also acknowledges that Idaho Power has increased its demand-side management (DSM) expenditures and savings in recent years. In particular, comparing the Company's 2006 and 2009 DSM Annual Reports reveals that Idaho Power increased the annual amount it spent on Idaho energy efficiency and demand response programs by 193% (from \$11.5 million to \$33.7 million). In those same years, the Company's estimated first-year annual energy savings from all of its energy efficiency programs increased by 111% (from 71,600 megawatt-hours [MWh] to 148,700 MWh), and its estimated peak load reductions from its demand response programs increased by 483% (from 37 megawatts [MW] to 218 MW).

Reflected in the above DSM expenditures and energy savings is the Company's continued support of, and participation in, the Northwest Energy Efficiency Alliance's (NEEA) regional efforts to transform energy efficiency markets and otherwise improve energy efficiency through strengthening building code and appliance standard requirements and compliances.

Clearly, Idaho Power has dramatically increased its DSM efforts during the three years that the FCA pilot has existed, but it is not at all clear how much, if any, of the DSM increase can

be attributed to the FCA's existence. Given that elimination of Idaho Power's financial disincentives for investing in residential energy efficiency is the FCA's primary purpose, a logical consequence of the FCA would be for the Company's energy efficiency efforts to have increased disproportionately more for those customers than for customer classes not affected by the FCA. In actuality, however, neither the Company's residential energy efficiency program expenses nor their reported energy savings increased as much as those for all other customer classes. For residential customers, Idaho Power increased its Idaho energy efficiency expenses 110% (from \$2.7 million in 2006 to \$5.6 million in 2009), while non-residential energy efficiency expenses increased 168% (from \$4.7 million to \$12.6 million). For the same years, the estimated first-year energy savings from residential programs increased by about 130% (from 11,300 MWh to 26,000 MWh), while the estimated energy savings from non-residential programs increased 188% (from 36,903 first-year MWh to 106,453 MWh).

Unfortunately, DSM expenses and savings estimates for Schedule 7's small commercial customers (the secondary FCA target) are not distinguishable from other commercial and industrial customer classes. DSM data specific to Schedule 7 customers should be separately identified given that customer class' FCA involvement.

Staff previously noted in 2008 in comments filed in IPC-E-08-04 (p. 8), "...there is no analysis provided to demonstrate or suggest that these additional [DSM] efforts would not have occurred in the absence of the FCA mechanism." It is still true today that there is no evidence that the FCA caused Idaho Power to increase its DSM efforts specifically for residential and small commercial customers beyond that which it would have in the absence of the FCA. There are many factors causing increasingly aggressive DSM to remain the Company's most cost-effective resource and there is no evidence that the FCA is the most important of those factors. As stated by the Company in its March 19, 2010, Reply Comments in IPC-E-09-09 (pp.3-4): "Idaho Power wants to administer energy efficiency because...it is an integral and increasingly important part of the Company's resource planning..."

FCA goes beyond DSM

Decoupling mechanisms are widely regarded as a means to remove the financial disincentive toward Company-sponsored DSM programs, not as a guarantee of fixed cost recovery between rate cases. However, the current FCA formula does not differentiate between the weather normalized variation in energy use per customer associated with the Company's energy efficiency programs and other economic factors. As an example of the potential

magnitude of this difference, in the Company's 2008 Annual DSM report, the Company's estimated residential program savings was 21,777,729 kWh.² Yet, the 2008 FCA reimbursed the Company for a decline in energy of 156,131,477 kWh. Therefore the Company is collecting lost fixed revenue for reductions in energy use due to factors other than its DSM programs. Similarly, when 2007 energy usage increased, the Company had to pay customers \$2,400,558, thus penalizing IPC for factors that did not have anything to do with its energy efficiency programs. While these potential problems were identified before the FCA was implemented, the magnitude of the problem was not.

Recently the Company and Staff came to terms on a measurement and evaluation plan for demand-side programs. *See* Case No. IPC-E-09-09. Commission Staff and Idaho utilities developed a Memorandum of Understanding (MOU), agreeing on the contents of a more comprehensive utility annual DSM report that would demonstrate a commitment to, and accomplishment of, objective and transparent evaluation of DSM efforts. As recognized in the MOU, "planning, implementing and evaluating DSM programs is not an exact science," but the Commission Staff and the industry are making efforts to improve the application of judgment and experience to facilitate continual program improvement. The MOU defined the process of conducting and reporting evaluation, measurement and verification (EM&V) of DSM programs.

One of the key measurement and verification issues of determining energy efficiency savings is defining the baseline, or the energy use absent the utility measure or program. The baseline is an integral part of determining program effectiveness, since energy savings is defined as the difference between energy consumption after implementation and what would have occurred during the same period had the efficiency measures not been installed. Baseline energy use can change for a number of reasons, including: (1) building code changes; (2) federal weatherization programs, tax incentives and appliance rebates; (3) federal marketing programs (e.g., - similar to an energy version of the "buckle-up" ad campaign); (4) technological changes; (5) substitutions between gas and electric equipment; (6) rate design changes; (7) shifts in the economy; and (8) other behavioral changes. It is the Company's responsibility to begin isolating the impact of these changes on residential and small general service consumption by conducting price elasticity, economic, load-research, and end-use market research studies.

² Staff notes this is the first-year annualized savings, thus substantially overstating savings that occurred in 2008, but does not include any cumulative savings associated with programs operated in prior years subsequent to the test year of the last rate case. Given the Company's prior DSM efforts, Staff believes the residential DSM savings mismatch is not material enough to affect Staff's position.

An example of the information Staff believes useful in evaluating the causes of reduced per-customer consumption outside of DSM can be found in Avista Utilities 2009 Electric IRP. In the document, Avista reviewed price and income elasticity of demand studies³ to factor into its long-term load forecasts. Along with the expected consumer response to higher prices, Avista acknowledged two additional impacts that affect electricity demand. The first is affordability. As incomes rise, a consumer's ability to pay for goods and services increases. The second impact is the amount and number of customers using equipment within their homes and businesses. As incomes rise, consumers are more likely to purchase more electricity-consuming equipment, live in larger dwellings and use electrical equipment more often, but often are less likely to live in residences with electric space and water heating.

Given the harsh local economic conditions of relatively high unemployment (9.1% Boise Metro) and declining wages (-2.6% Idaho), combined with the actual level of documented DSM savings during the pilot period, it is evident that the decoupling mechanism has tracked the effects of price elasticity of demand from rate increases (and rate design alterations) along with income elasticity from atypical economic conditions consumers have recently faced. Staff believes both of these conditions have contributed to reduced energy consumption in the Idaho Power service territory, which consequently is captured through the FCA. Again, Staff has always been aware of the potential for the mechanism to track and reimburse the Company for non-DSM related reductions in energy consumption, and quantifying the magnitude of such reductions continues to be very difficult.⁴

Staff is aware of the Company's efforts to make identification of its DSM and energy efficiency savings more accurate. Idaho Power is currently developing a new process to track program savings and expenses by rate schedule that will be implemented in 2010. Once this new process is implemented, the Company should be able to conduct market research on the key factors influencing intra-class variations in energy use and savings. This information could be useful in further analyzing the FCA mechanism at the end of an extended Pilot Program.

³ Price elasticity is a measure of the responsiveness of buyers to changing prices, while income elasticity measures the responsiveness of buyers to changes in income levels.

⁴ Staff notes that in its most recent effort at modeling residential per-customer usage, weather explained the majority of sales variation, leaving little room for generalized socioeconomic and DSM variables to provide insight into the impact of the FCA. Staff draws two conclusions: Company-sponsored DSM programs marginally contribute to the variation in residential customer sales; and more granular data is necessary to adequately address use per-customer modeling.

Unresolved Issues

In its support of the Stipulation creating the FCA pilot program, Staff noted several concerns it had regarding the evaluation of the mechanism. *See* Case No. IPC-E-04-15, Lobb Direct, p. 6. Several of these issues have not been resolved during the initial pilot stage, particularly the impact new customers have on the collection of fixed costs and how the Company's DSM efforts would be different had the Commission not approved the FCA Pilot. In addition, with more than two years of experience with the Pilot Staff has discovered additional challenges associated with the FCA that were unseen during its development.

Perhaps the foremost concern when considering the validity of a fixed cost recovery mechanism is whether it results in a measurable change in utility practices. Idaho Power has stated in its Application, its 2009 DSM Report and its 2009 Integrated Resource Plan that the FCA has been a significant factor in improving its efforts toward energy efficiency and DSM, but Staff has not been able to fully attribute expansion of Company DSM programs to the FCA. While it is possible that the FCA has played a part, Staff believes in this current environment that there are a number of factors that make the Company's commitment to DSM in its own best interest. Such factors may include: (1) the Company's share of escalating power supply costs, tracked through the power cost adjustment mechanism (PCA); (2) an interest in demonstrating that it has been pursuing all options in order to support its recent acquisitions of (or intent to acquire) additional supply-side resources; and (3) pressure both internally and externally to reduce its reliance on fossil-fuel based resources could all have resulted in expanded DSM programs.

In support of the Stipulation, Staff expressed concerns about the fixed costs associated with new customers. Changing household demographics, as noted above, may cause dramatic shifts in per-customer usage patterns over time, which have no direct tie to the DSM efforts of the Company. There have been proposals around the nation to capture "trends" in new customer usage in-between general rate cases to prevent predictable windfalls or losses to the utility (commonly known as a K-factor). Staff previously evaluated whether such a mechanism should be made a part of the FCA Pilot, and concluded that such a mechanism would add complexity to the program without substantially increasing accuracy. Staff therefore agreed in the Stipulation to add new customers at the average fixed cost per customer previously approved by the Commission.

While Staff does not intend to propose a K-factor adjustment to the FCA, it does believe that the issue of cost to serve new customers deserves to be reevaluated. The authorized fixed costs are based on results from the most recently approved cost of service model which include generation, transmission, distribution and customer costs. Generation and transmission investments are uneven, and tend to be the impetus for rate case proceedings. These fixed investments are not made as individual customers are added, and therefore are potentially over collected in the current FCA mechanism. What remains are the distribution and customer costs, which make up over half of the FCC once customer charges are accounted for. Staff believes that the FCC and FCE can be established in the same manner currently in practice, using the most recently approved (or agreed upon) cost of service methodology. As customers are added, a second allowed FCC and FCE would be based on the distribution and customer costs within the same cost of service study. Staff believes that this methodology may more accurately reflect the fixed costs associated with new customers in between rate cases. Continuation of the FCA pilot would allow further refinement of new customer fixed costs.

Staff is also concerned that the load growth adjustment rate (LGAR) built into the PCA may have the unintended consequence of overcompensating the utility for lost fixed costs during periods of declining sales. Both the FCA and the LGAR in the PCA may be reimbursing the Company for the same lost fixed generation revenue.⁵ Conversely, this phenomenon does not appear to occur when sales increase and use per customer either increases or decreases. This is one area that needs to be further investigated before the FCA is made permanent.

A further complication with the FCA is the impact the newly-instituted tiered rate structure has on collection of fixed costs. As a result of Commission Order No. 30722, IPC has instituted year-round 3-tiered rate structures for residential customers⁶ and 2-tiered structures for small commercial customers. Prior to the upcoming 2009 FCA filing, the Company's 2-tiered summer rate structure had such a *de minimus* affect on the collection of authorized fixed costs that Staff and the Company did not factor it into the collection process. With the new rate structure, Staff foresees the 2009 FCA filing to be more complicated with regard to assessing the level of fixed costs actually collected. For example, neither party has indicated whether the

⁵ To be more precise, the FCA recoups a portion of generation costs associated with the two affected customer classes, and any portion of generation costs shifted from other customer classes as a result of deviation from cost of service.

⁶ This only applies in the non-summer months for a small number of customers taking service under Schedules 4 and 5, and does not apply to Schedule 3 customers who are charged a flat energy rate.

stated fixed cost per energy (FCE) is a percentage of the commodity rate or if it is a fixed cents-per-kWh value. Should it be the former, the highest tier represents the greatest exposure to under collecting approved fixed costs as the rate contains a greater portion of the approved fixed costs. Should it be the latter, the risk of under collection is appreciably less than the other scenario. Staff believes that extending the pilot allows further analysis of rate design impacts on fixed cost recovery.

Finally, Staff believes that the option to allow a single FCA rate for both residential and commercial classes should be maintained and the Company's request to remove the option should be denied. In both the 2007 and 2008 FCA filings, Staff supported a blended FCA rate on a number of grounds, most notably that the underlying cost of service methodology is an inexact science, and based on an unapproved model. These concerns have not changed. Also, blending the rates has prevented the Company from deferring a significant amount of unrecovered fixed costs associated with the small commercial customers. This not only benefits the Company from a cash flow perspective, but has prevented the deferral balance from a "snowball effect", in which the balance grows annually to a point where collection of the full amount becomes nearly impossible.

Public Understanding of the FCA

Although the Commission has not received any comments from the general public specific to this case, the Commission's Consumer Assistance Staff has received complaints and questions from customers about the FCA. Some customers believe that the FCA penalizes them for saving energy; the less energy customers use, the greater the amount the Company is allowed to recover through the FCA for lost revenue. If the customer does not participate in any of the Company's DSM programs, the customer does not receive a cash incentive or bill credit yet pays for the DSM programs through the Energy Efficiency Services Rider and pays for the lost revenue associated with DSM program participants' energy savings. Often the customer does not understand that the FCA is intended to recover only a portion of the Company's fixed cost associated with a decline in energy sales that can be attributed to its DSM programs. Instead, the customer thinks the FCA simply compensates the Company for declining revenue or provides the Company with a profit that it would otherwise not realize when revenue declines. Although these opinions are based on a misunderstanding of how the FCA works, they are nevertheless commonly-held opinions. Unfortunately, this can easily discourage people from conserving energy and erode public support for DSM programs.

Most customers do not understand ratemaking principles, and is it unreasonable to expect them to recognize the complexities of various rate adjustment mechanisms such as the FCA. It is important that the benefits of the FCA not be expressed in vague terms or phrases that are easily misinterpreted by customers or conveyed using concepts that are meaningless to customers. If the Commission agrees that the FCA should be continued, the Company should improve its communication with customers so that they can more fully understand the justification for the FCA and how both customers and the Company benefit from the FCA and DSM programs. Staff recommends that the Commission direct the Staff and Company to work together to improve communication with customers.

Staff also recommends that the FCA be moved from the Energy Efficiency Services line item on customer bills and be combined with the PCA to form a new line item entitled "Annual Adjustment Mechanisms" or a similar term. From a practical perspective, both the FCA and PCA adjust annually (and concurrently). The Energy Efficiency tariff rider, which is currently combined with the FCA in a line item, changes far less frequently. The transparency of customers' bills has become an issue as energy rates have increased, the residential rate design has changed, and the cap on the amount that residential customers pay under the Energy Efficiency tariff rider was eliminated. The amount that actually appears on bills under the Energy Efficiency Services line item is higher than the tariff rider itself due to the addition of the FCA. The fact that the Energy Efficiency tariff rider is 4.5% of base rate charges and the FCA is a fixed charge per kWh increases the complexity of the calculation for customers trying to verify that their bill is correct, if in fact they are aware of the FCA "adder" to this line item. Staff believes that this is a simple step that will improve customers' understanding of the components that make up the overall bill.

STAFF RECOMMENDATIONS

Staff continues to maintain that DSM can be the most cost effective resource for meeting Company load. All customers benefit when the Company acquires DSM energy savings at costs that are lower than alternative supply side resources. Staff also believes there is a financial disincentive for the Company to aggressively pursue cost effective DSM when doing so reduces recovery of prudently incurred Commission approved fixed costs.

Staff recognized the short comings of the current FCA mechanism when it was first implemented. Broad recovery of lost fixed revenue beyond the effect of Company DSM, cost

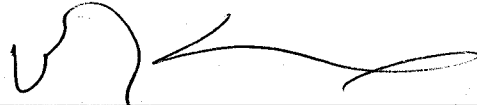
recovery of fixed costs that have not been approved by the Commission for new customers and the difficulty of assigning fixed cost responsibility to various customer classes are still problems today. New problems are potential double recovery of fixed costs through the PCA LGAR and the effect of tiered rates. While Staff does not support making the FCA mechanism permanent at this time, it does support continuation of the mechanism on a pilot basis. Staff recommends that the FCA be continued as a pilot program for two more years to allow time to address a number of the unresolved issues. Continuance of the Pilot affords both the Company and Staff an opportunity to better understand the factors that affect energy consumption per customer, which may provide a more defensible rationale for either maintaining or eliminating the FCA. During an extended pilot period, Staff recommends that the option to blend the credits or surcharges for the two affected customer classes remain.

Staff believes the public would be well served by Company efforts to improve awareness of what the FCA is, how the FCA affects Idaho Power's investment in DSM, and why DSM is a valuable resource for all customers. Staff recommends that the Commission direct the Company to educate its customers on the benefits of the FCA and DSM programs in order to mitigate the negative misconceptions many customers have. Staff also believes that the FCA should be moved out of the Energy Efficiency Services line item on customer bills and combined with the PCA to create an annual adjustment line item. Doing so may help improve customers' understanding of the billing components.

Staff further recommends that distinguishing between existing customers and customers added between general rate case proceedings be investigated to more accurately identify fixed costs for new customers. Staff believes limiting cost recovery to distribution and customer costs incurred to serve new customers may be both more equitable and relatively simple to administer.

Staff believes the current methods of monthly reporting for the current FCA mechanism are sufficient, and recommends that monthly FCA reports continue to be submitted concurrently with the monthly PCA reports.

Respectfully submitted this 25th day of March 2010.



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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 25TH DAY OF MARCH 2010, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NO. IPC-E-09-28, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

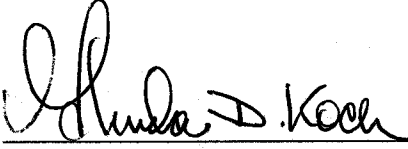
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