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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 IMPLEMENT A TRACKING MECHANISM TO RECOVER ITS DEFINED BENEFIT PENSION EXPENSE.	CASE NO. IPC-E-09-29

IDAHO POWER COMPANY

DIRECT TESTIMONY

OF

KEN W. PETERSEN

Q. Please state your name and business address.

A. My name is Ken W. Petersen and my business address is 1221 West Idaho Street, Boise, Idaho.

Q. By whom are you employed and in what capacity?

A. I am employed by Idaho Power Company ("Idaho Power" or "Company") as the Corporate Controller.

Q. Please describe your educational background.

A. I graduated in 1987 from Boise State University, Boise, Idaho, receiving a Bachelor of Science degree with a double major in Accounting and Computer Information Systems. I also received a Masters in Business Administration from Boise State University in 1995. I have attended numerous accounting and regulatory courses, including the University of Idaho's Public Utility Executive Course in June 2006. I am currently licensed in Idaho as a Certified Public Accountant.

Q. Please outline your business experience.

A. Before joining Idaho Power, I spent eleven years in various accounting and finance leadership roles with both private and publicly traded companies. In 1998, I joined Idaho Power as Finance Team Leader and was promoted to Delivery Business Unit Controller in 1999. In 2005, I was promoted to General Manager of Delivery

Services & Delivery Controller. In 2007, I was promoted to Corporate Controller.

Q. What are your duties as Corporate Controller?

A. I am responsible for the Company's accounting and external financial reporting processes. Additionally, I oversee the corporate budgeting and internal reporting process, including financial support for the business units.

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

A. The purpose of my testimony is to describe Idaho Power's proposal to establish a pension expense tracking mechanism for the recovery of costs associated with the Company's obligations to provide pension benefits to its employees. I will also discuss the related accounting issues associated with pension expense, including consequences to the Company of certain actions, and describe why the absence of a tracking mechanism could result in a substantial impact on the Company's income statement and equity position.

DESCRIPTION OF PENSION PLAN

Q. Please briefly describe Idaho Power's pension plan.

A. The plan was established in 1943 and continues as part of the Company's total compensation package for employees. The plan is a defined benefit pension plan covering all eligible employees of Idaho Power Company. Idaho Power's Fiduciary Committee controls and manages the operation and administration of the plan. The Bank of New York (the Trustee) serves as the trustee of the plan and, together with several investment managers, manages the plan's investments under the oversight of the Fiduciary Committee. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended.

As part of the Company's total compensation package, employees receive pension benefits, payable at normal retirement age, after accumulating five years of vested service, as defined by the plan. There is no partial vesting of benefits. The plan provides for normal retirement upon reaching age 65, early retirement with reduced monthly benefits as early as age 55 with 10 years of service, or retirement at any age with reduced monthly benefits (if before age 65) with 30 years of service. As of January 1, 2009, Idaho Power had 2,085 active employees in the plan and a total of 3,533 plan participants.

PENSION ACCOUNTING RULES

Q. Please generally describe the traditional accounting treatment prescribed by the Financial Accounting Standards Board ("FASB") to account for pension costs.

A. Before discussing the accounting rules for pension, I should note that the FASB recently adopted a change to the authoritative source of accounting guidance. Formerly, authoritative accounting literature was scattered throughout various pronouncements. The FASB recently consolidated all of the current authoritative accounting literature into one source, the Accounting Standards Codification ("ASC"). The prior technical accounting requirements were not affected by this change; however, references to Statements of Financial Accounting Standards ("SFAS") to which I will continue to refer in this testimony are, strictly speaking, no longer authoritative. The provisions of SFAS 71 are now primarily incorporated in ASC 980 and those of SFAS 87 are primarily incorporated in ASC 715. The ASC is now the authoritative source. However, for the sake of simplicity, and in order to avoid confusion, I will be referring to the accounting literature by the more familiar pronouncement references rather than by the location of the guidance in the ASC.

Prior to the issuance of SFAS 87, accounting for pension plans varied greatly among companies. As a result, pension cost was not easily comparable from company to company or even from year to year. If a company currently funded a pension plan, there was pension expense. If it did not currently fund a pension plan, there was no pension expense. The FASB issued SFAS 87 in order to better match the compensation cost of an employee's pension benefits with the time period over which the employee earns those benefits, and also to provide for greater comparability between companies and consistency for the same company in its reporting from year to year. Instead of being based on current cash payments, SFAS 87 net periodic pension expense (or accrual) methodology is generally based on three primary components: (1) benefits earned by employees during the year (the service cost), (2) increases in the present value of future benefits already earned as those benefits become one year closer to being paid (interest cost), and (3) returns on assets set aside for funding future benefits (expected return on assets).

Q. Does Idaho Power account for pension costs based on net periodic pension expense methodology per SFAS 87?

A. Yes. As required by generally accepted accounting principles ("GAAP"), Idaho Power began accounting for pension cost per SFAS 87 in 1986 and has continued to apply SFAS 87 methodology.

Q. What is unique about Idaho Power's pension cost treatment that makes its situation different from other utilities with defined benefit pension plans?

A. The Company has continued to account for pension cost based on SFAS 87; however, following Commission Order No. 30333 issued on June 1, 2007, the Company began deferring the SFAS 87 pension expense to a regulatory asset as required by the Order rather than expensing it for GAAP purposes. This accounting treatment effectively creates a cash-based accounting for pension costs.

Q. Because the Company records expense on a cash basis, is net periodic pension cost from SFAS 87 ignored?

A. No. The Commission's Order No. 30333 does not invalidate SFAS 87. The Order confirms that SFAS 71 provides for a deferral of the SFAS 87 expense until Idaho Power recovers those costs in rates. The entry to record SFAS 87 expense is still recorded; however, rather than debiting other operations and maintenance expense for pension expense, Idaho Power records a regulatory asset. The credit side of the entry is the pension liability account, the same as it was prior to the Commission's Order.

Q. Is this treatment consistent with GAAP?

A. Yes, SFAS 87 provides guidance for regulated utilities when a method for pension expense other than SFAS 87 is used for ratemaking purposes (e.g., recovery on a cash basis). The guidance indicates that an asset (or a liability, potentially) would be created for the difference between the pension expense recorded under SFAS 87 and used for ratemaking if the conditions in SFAS 71 for recording a regulatory asset have been met (SFAS 71, Appendix E, paragraph E4). In other words, a utility recovering pension costs on a cash basis would defer the excess (or accrue the deficiency) of SFAS 87 expense over the amount included in rates for pension costs if the SFAS 71 conditions are met.

Q. What are the SFAS 71 requirements for recording a regulatory asset?

A. Two conditions must be met in order to record a regulatory asset for ". . . an incurred cost that would otherwise be charged to expense . . . ." First, it must be "probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes." The second condition is that available evidence must indicate "future revenues will be provided **to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. . . .**" (SFAS 71, paragraph 9, emphasis added.)

Q. What is meant in the second criterion, when SFAS 71 states that "future revenues . . . permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs?"

A. I understand this criterion to mean that, if the Company included cash pension contributions as test year expenses in a general rate case without there being a true-up mechanism, the deferral of SFAS 87 pension costs prescribed by Order No. 30333 would no longer be permitted under SFAS 71 and SFAS 87.

Q. Why is this distinction important?

A. There are two principal reasons. First, recovering similar future costs does nothing to recover the amounts previously deferred. Second, inclusion of test year costs in future rates creates the possibility that the actual future costs will exceed the amount provided for in rates to cover those costs. This situation does not provide adequate assurance to meet the first condition for recording a regulatory asset - i.e., that it is "probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes."

Q. Would the inclusion of a known and measurable estimated future amount overcome this defect?

A. No, it would not, unless an annual or other periodic update is provided for. Even then, there is no guarantee that the amount calculated by the Company's actuary as the minimum required contribution will not change after it has been included in the test year. It is possible, for instance, that changes in laws or regulations could cause the Company to be required to fund more or less than originally calculated.

Q. How must the recovery be structured then to enable the Company to meet this condition?

A. Again, the Standard requires that "future revenues will be provided to permit recovery of the previously incurred cost." In order to meet the conditions for deferring pension costs under SFAS 71, some form of a mechanism must be in place that assesses whether actual costs during the recovery period exceeded the amounts included in rates, tracks any shortfall, and adjusts rates accordingly. The tracking mechanism Idaho Power is proposing would meet that requirement.

Q. Do customers benefit from the Company's proposed pension tracker?

A. Yes. A tracker assures that the Company does not over-collect from its customers. A tracking mechanism provides protection to customers in years when plan contributions are less than what would have otherwise been included in rates. Volatility of both the net periodic pension cost and required contributions creates the risk that the customers will either over or under pay for pension costs. The Company's proposed tracker ensures that customers pay no more and no less than the amounts actually needed to fund the pension plan. Also, by including carrying costs, neither the Company nor customers unjustifiably benefits from over- or under-collection of costs through rates during the course of the year.

IMPACTS OF DERECOGNITION

Q. What is the impact or potential impact of simply including cash contributions in Idaho Power's revenue requirement during its next rate case absent a tracking mechanism?

A. As described above, that strategy creates a strong likelihood that the Company will no longer be able to apply SFAS 71 methodology to the deferral of SFAS 87 pension expense. If SFAS 71 methodology did not apply, Idaho Power would be required to derecognize its regulatory asset for deferred pension expense through a reduction in income. At September 30, 2009, the balance in this account is $33 million. The Company would no longer meet the accounting criteria for deferring pension expense pursuant to Order 30333. I believe the result would be a strong negative reaction from the already volatile financial markets, potentially impacting the Company's ability to access those markets to meet its financing needs.

Q. Are there other potential impacts in addition to a $33 million dollar write off if cash contributions were simply part of a revenue requirement in a rate case rather than as part of the proposed pension tracking mechanism?

A. Yes. Idaho Power has two pension-related regulatory assets. I previously discussed the regulatory asset for the deferral of pension expense. The second regulatory asset, authorized by Order No. 30256, defers the equity impacts of the Company's adoption of SFAS 158. This regulatory asset would also be jeopardized.

Q. Please explain SFAS 158 and what was provided for in Order No. 30256.

A. SFAS 158 requires the Company to record a liability for its unfunded projected benefit obligation. The unfunded projected benefit obligation is defined by SFAS 158 as the difference between the market value of the plan's assets and the actuarially determined projected benefit obligation. The accounting standard requires that in the entry to record the unfunded projected benefit obligation, a corresponding decrease is to be recorded (net of deferred taxes) in accumulated other comprehensive income ("AOCI") in the equity section of the balance sheet. Order No. 30256 permits Idaho Power to defer the AOCI impact of SFAS 158 because, at the time of the Order, the Company expected recovery of future pension costs.

Q. If rather than adopting the pension tracking mechanism, how would including cash contributions in test year expenses impact the regulatory asset created by Order No. 30256?

A. If Idaho Power determines that its pension costs no longer meet the deferral criteria discussed above, it is likely that the AOCI impact of SFAS 158 for the pension plan would also cease to qualify for deferral, resulting in the derecognition of the SFAS 158 regulatory asset and a decrease in AOCI. As argued in the Company's Application in Case No. IPC-E-06-33, this change would affect the calculation of the Company's revenue requirement in future rate cases and affect capitalization ratios used by regulatory bodies, credit rating agencies, and covenants of debt financings. Further, it would cause the Company's equity and capitalization ratios to be subject to greater volatility due to changing market prices of plan assets and discount rates used to measure the plan obligation.

Q. Please quantify the impact of derecognition to the Company.

A. As of September 30, 2009, the deferred AOCI (which is an amount net of deferred taxes) related to the pension plan is approximately $92 million. If the regulatory asset was derecognized, equity would decrease by $92 million. This decrease would be in addition to the retained earnings impact of derecognizing the regulatory asset for deferred pension expense.

Q. Are there any serious impacts if equity is decreased in this manner?

A. Yes. One significant impact would be on the Company's capitalization ratio. The Company has traditionally maintained a debt-to-equity capitalization ratio of roughly 50 percent debt, 50 percent equity. The current ratio, as reflected in the Statement of Capitalization on the Company's financial statements, is

50.3 percent debt and 49.7 percent equity for Idaho Power. Ratings agencies look at the debt-to-equity ratio as one important factor in considering the appropriate credit rating for the Company. A higher equity ratio is generally more supportive of a more favorable credit rating than a lower ratio. Removing $125 million dollars ($33 million of deferred SFAS 87 costs and $92 million of deferred AOCI under SFAS 158) of equity from the Company's current capitalization would lower the equity percentage by roughly 2.5 percent. Because the equity ratio is one item considered out of many in determining a credit rating for the Company, it is difficult to say with certainty if that percentage change would result in a downgrade; however, it would certainly be a negative influence on the Company's credit rating.

Q. Are there other concerns you have about the potential derecognition of both regulatory assets created by Order Nos. 30333 and 30256 if a pension expense tracking mechanism is not adopted?

A. I am concerned that the financial markets and the credit rating agencies may view derecognition of significant regulatory assets negatively. The impacts of such a change are not currently anticipated by them and it could call into question the Company's ability to rely on regulatory assurances in the future.

Q. What other financial impacts would derecognition create?

A. Assuming the Company would try to maintain its current credit rating, additional capital would need to be raised through the issuance of additional shares, creating lower earnings per share for the Company's shareowners. This dilutive effect would result in downward pressure on the Company's stock price and make financing the infrastructure needs of the Company more difficult. If its credit rating was not maintained, the Company would incur additional debt costs. Ultimately, both of these scenarios would drive the Company's revenue requirement higher.

DESCRIPTION OF TRACKING MECHANISM

Q. Generally, how would the tracker work?

A. Similar to the Company's current Power Cost Adjustment ("PCA") process, the Company would determine the estimated cash payments for March 1 through February 28 (February 29 in a leap year). Those estimated or forecasted payments would be effective in rates beginning June 1 each year. This schedule allows for an evaluation of actual payments in the period as well as actual collections through rates, which would generate a true-up, including carrying costs that would be applied along with the next year's forecast. Company witness Timothy Tatum's testimony describes the mechanics of the tracker in greater detail.

ACCOUNTING ENTRIES

Q. Please describe the accounting entries associated with the Company's proposal.

A. I have included the accounting entries in Exhibit No. 2. I will describe each of these entries below.

Q. What is the entry to record a cash contribution?

A. The initial entry to record a cash contribution to the pension plan is the same as it would have been absent Commission Order No. 30333. Cash is reduced (credited) and the Company's pension liability, established through the SFAS 87 accrual, is also reduced (debited). This is similar accounting to the payment of any liability. The entry is detailed in Exhibit No. 2 as Entry 1.

Q. What entries do you propose to use with a tracking mechanism?

A. When a contribution is made, the amount of the contribution would be moved from the SFAS 87 expense deferral account into a new pension tracker regulatory asset subaccount as presented in Entry 2.

When Idaho Power begins collecting pension costs in rates, it will record the associated revenue as presented in Entry 3.

Pension costs in an equivalent amount would also be amortized to expense over the amortization period, reducing the pension tracker regulatory asset as presented in Entry 4.

The carrying charge would be accrued each month based on the balance in the regulatory account. If that balance is in an asset position, the Company will accrue income as presented in Entry 5a.

If the balance is in a liability position instead of an asset, the Company will accrue expense as presented in Entry 5b.

The amount remaining in the pension tracker regulatory asset at the end of the year (including carrying costs) would be the true-up amount for the following year.

FUNDING REQUIREMENTS

Q. What is the plan's minimum required contribution?

A. It is the minimum amount Idaho Power is required to contribute to its defined benefit pension plan's trust fund as required under the ERISA as amended by the Pension Protection Act of 2006 ("PPA"). The Company is required to meet the funding requirements under ERISA in order for the plan to maintain its tax exempt status as a qualified plan.

Q. How is the minimum required contribution determined?

A. The minimum required contribution is determined by the Company's actuary, Milliman, Inc., based on the calculations prescribed by the PPA. The calculation is based on two primary measures defined by the PPA: (1) the current year's benefit accruals ("normal cost") and (2) the funded status of the plan at the beginning of the year. Generally speaking, the required amount to be funded is the normal cost increase by amortization of the underfunded amount or decreased by the amount by which the plan exceeds full funding (up to the normal cost).

Q. When are the contributions required to be paid?

A. If the plan is fully funded as defined by the PPA, the required contribution for a plan year is due by September 15 of the following year. If the plan drops below full funding, the Company will be required to begin making quarterly payments. Those quarterly payments will be due April 15, July 15, and October 15 of the plan year and January 15 of the following year.

Q. Does the Company intend to contribute only the minimum contribution to its pension plan required by ERISA?

A. Though the mechanism being proposed in this Application primarily contemplates recovery based on minimum funding amounts, it is difficult to state categorically that the Company will only contribute minimum amounts under ERISA. There could be limited situations in which factors other than ERISA requirements - compliance with debt covenants, for instance - could impose on Idaho Power a need to fund the pension plan beyond what is required by ERISA. Additionally, it is possible that circumstances may arise in which it is simply prudent to fund in excess of the current minimum required contribution. However, the Company expects this to be the exception rather than the rule.

The Company recommends that pension contributions based on the minimum funding requirements under ERISA be included as a standard practice in the forecast. Because excess contributions will act to reduce required contributions in future years, the Company recognizes that the Commission may desire to address discretionary payments made either in excess of the minimum amount or in advance of the final due date on a case-by-case basis to determine whether those amounts should be included in the current forecast or deferred for recovery in future years. If the excess amounts are deferred to future years, the Company requests that those amounts earn a carrying charge.

Q. When does Idaho Power receive the calculation of the minimum contribution from its actuary?

A. Historically the Company receives this calculation in May or June. However, in order to accommodate making any required quarterly filing due on April 7 and in order to make the forecast filing under this proposed mechanism, the Company's actuary has indicated that he will provide the calculation for each year in March.

Q. Will the amount provided by Idaho Power's actuary and included in the April filing constitute a final number?

A. Generally speaking, Idaho Power expects that the actuarial value included in the April filing will be the actual required payment in the subsequent year. However, it is possible that adjustments will be identified after the Company has made its annual pension tracker filing. Such adjustments will be addressed in the true-up portion of the next year's filing. Inclusion of a carrying charge will help to ensure that the Company will not inappropriately benefit from after-the-fact adjustments to the calculation.

Q. Has the Company's actuary informed you that Idaho Power is required by ERISA to make a minimum required contribution?

A. Yes. Idaho Power's actuary has informed the Company that a contribution is required for the tax year beginning January 1, 2009.

Q. When is this contribution required to be made?

A. The contribution for 2009 is due by the extended due date for the federal income tax return of the plan's sponsor (Idaho Power), or September 15, 2010.

Q. How much is the 2009 required contribution?

A. As of January 1, 2009, the required contribution is $5,092,774. However, this amount accrues interest from that date at 8.15 percent. If not paid by October 15, 2009, the required amount increases to $5,418,662. If delayed until the final due date of September 15, 2010, the Company is required to contribute

$5,822,145. The Company did not make an October 15, 2009, payment.

Q. To whom is the interest on the minimum required contribution paid?

A. The interest that is added to the required amount is not a penalty. It simply increases the required payment due to the timing of the contribution. All of the funds contributed by the Company, including interest, become plan assets and are invested for the purpose of being used to pay future benefits.

Q. Do you have any other comments?

A. Yes. Based on my analysis and familiarity with Idaho Power's pension plan, I believe the Company's proposal is in the best interests of its customers and the Company.

Q. Does that conclude your testimony?

A. Yes, it does.

BEFORE THE

IDAHO PUBLIC UTILITIES COMMISSION

CASE NO. IPC-E-09-29

IDAHO POWER COMPANY

PETERSEN, DI
TESTIMONY

EXHIBIT NO. 2

PROPOSED ACCOUNTING ENTRIES

		Debit	Credit
Entry 1			
228321	Accumulated provision P&B - accrued pension liability	aaa.aa	
	131XXX Cash		aaa.aa
	(To record a contribution to Idaho Power Company's pension plan)		
Entry 2			
1823XX	Other regulatory assets - pension tracker	aaa.aa	
	182321 Other regulatory assets - SFAS 87 deferral		aaa.aa
	(To record a regulatory asset for the pension plan contribution)		
Entry 3			
142XXX	Customer accounts receivable	bbb.bb	
	44XXXX General Business Revenue		bbb.bb
	(To record revenues attributable to the pension tracking mechanism)		
Entry 4			
926200	Employee pensions & benefits - pension expense	bbb.bb	
	1823XX Other regulatory assets - pension tracker		bbb.bb
	(To record amortization of the pension contributions to match revenues)		
Entry 5a			
1823XX	Other regulatory assets - pension tracker	ccc.cc	
	421XXX Miscellaneous nonoperating income		ccc.cc
	(To record the carrying charge on the pension tracker regulatory asset)		
Entry 5b			
431XXX	Other interest expense	ddd.dd	
	254XXX Other regulatory liabilities - pension tracker		ddd.dd
	(To record the carrying charge on the pension tracker regulatory liability)		