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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** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission (Commission), by and through its attorney of record, Scott Woodbury, Deputy Attorney General, and in response to the Notice of Application, Notice of Intervention Deadline, Notice of Modified Procedure and Notice of Comment/Protest Deadline issued in Order No. 30945 on November 17, 2009 in Case No. IPC-E-09-29, submits the following comments.

BACKGROUND

On October 20, 2009, Idaho Power Company (Idaho Power; Company) filed an Application with the Idaho Public Utilities Commission (Commission) requesting approval on or before February 12, 2010 of a mechanism to track and recover annually the Company's defined benefit pension expenses. The Application does not seek current approval of future expenses associated with the Company's qualified defined benefit pension plan, nor is the Company requesting that current rates be changed at this time.

Idaho Power's defined benefit pension plan was established in 1943 and continues as part of the Company's total compensation package for eligible employees. As of January 1, 2009, Idaho Power had 2,085 active employees in the plan and a total of 3,533 plan participants.

In 1986, the Company adopted Statement of Financial Accounting Standards (SFAS) 87. That Standard addresses pension funding issues from an accrual perspective in an attempt to better match the compensation cost of an employee's pension benefits with the time period over which the employee earns those benefits and to provide for greater comparability between companies from year to year. Prior to the adoption of SFAS 87, pension expense was based on the amount a company chose to contribute to its plans during the year. Since the adoption of SFAS 87 in 1986, the Company has filed general rate cases in 1994 and 2003 that dealt with pension funding issues. With the Company's 1994 general rate case filing, the Company included pension costs in test year O&M expenses based upon the SFAS 87 accrual perspective rather than cash contributed to the plan. The amount approved was approximately $2 million per year.

In its 2003 general rate case Application, Case No. IPC-E-03-13, Idaho Power deviated from the SFAS 87 accrued expense and requested annual recovery of the operating portion of the Company's 2004 service cost of $10,173,344. The Commission Staff recommended that the Commission reject the use of the service cost amount to be included in the Company's revenue requirement because the Company did not have any actual cash contribution requirements during the test year and would not be required to fund contributions in the foreseeable future. Furthermore, the Company had not contributed to the plan at all during the previous eight years while receiving $2 million annually from customers through rates. The Company in rebuttal testimony retracted its proposal. The Commission in Order No. 29505 did not include any defined benefit pension expense in rates since no cash contributions were made.

In 2007, Idaho Power filed an Application with the Commission (Case No. IPC-E-07-07) seeking clarification that the Company could expect to recover pension costs based on cash contributed to the plan and account for defined benefit pension expenses on a cash basis rather than the accrual basis that the Company had used from 1994 until 2003. In conjunction with the Company's request for clarification of its authority to utilize cash basis accounting for recovery of defined benefit pension expense, the Company also requested authority to defer future cash contributions it would make to its defined benefit pension plan and to record these future defined benefit pension plan cash contributions as regulatory assets.

On June 1, 2007, the Commission issued Order No. 30333 authorizing the Company to account for its defined benefit pension expense on a cash basis, and to defer and account for accrued SFAS 87 pension expense as a regulatory asset. As part of its Order, the Commission acknowledged that it is appropriate for the Company to seek recovery in the Company's revenue requirement of reasonable and prudently incurred defined benefit pension expense based on actual cash contributions. Since the deferred accounting treatment for cash contributions was approved in Case No. IPC-E-07-07, the Company has made no cash contributions and therefore has not made a request for recovery. The Commission found it reasonable for Idaho Power to defer the expense associated with the pension plan cash contributions and record them as a regulatory asset. The Commission also stated "when the Company's actuaries notify the Company of Employee Retirement Income Security Act of 1974 (ERISA) minimum funding requirements, the Company can evaluate the circumstances for ratemaking purposes and make a filing requesting ratemaking treatment, if needed."

Idaho Power's actuary has informed the Company that a contribution is required for the tax year beginning January 1, 2009. The required contribution will be $5,418,662 if paid by October 15, 2009, but if not paid by October 15, 2009, interest will accrue until the extended due date for Idaho Power's federal income tax return of September 15, 2010. The Company did not make an October 15, 2009 payment.

TRACKING MECHANISM

The requirement to make cash payments, Idaho Power contends, is expected to continue over the next several years, but may vary dramatically from year to year. Therefore, the Company requests authorization to implement a defined benefit pension expense tracking mechanism that has similar components to those of the Power Cost Adjustment (PCA) mechanism. That is, the proposed mechanism would include a forecast component and true-up component.

As reflected in its Application, the Company would recover through rates its forecasted annual cash payments toward defined benefit pension expense based upon an actuarial determination of those anticipated required contributions. Each year, the Company would compare the revenue collected through the tracking mechanism's forecast component rate with the actual cash contributions to defined benefit pension expense during the year. Any difference would be either refunded or collected from customers over the subsequent 12-month period in the true-up component. The Company recommends that a carrying charge equal to the Commission-approved interest rate for deposits be applied each month based on the balance in the regulatory asset account.

The Company proposes a March 1 through February 28 (February 29 in leap years) annual test period with rate adjustments becoming effective each June 1. The Company proposes to make an annual filing under the tracking mechanism on or before April 7 of each year with the associated rate adjustment effective June 1.

Idaho Power requests that it be allowed to recover its defined benefit pension expense as a percentage rate applied to all base revenue in a manner similar to the Energy Efficiency Rider, Schedule 91. Attachment 1 to the Application contains the Company's proposed Schedule 53 detailing the purpose and applicability of the proposed tracking mechanism.

ACCOUNTING TREATMENT

In order to qualify for deferral, SFAS 71 requires that a utility be able to demonstrate 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, Idaho Power contends that some form of a mechanism must be in place that assesses whether the actual costs during the recovery period exceeded the amount in rates, tracks any shortfall or excess, and adjusts rates accordingly.

Idaho Power believes that the proposed tracking mechanism would meet that requirement. Absent such a tracking mechanism, inclusion of pension contributions as test year expenses in a general rate case will most likely cause pension expense to become ineligible for deferral under SFAS 71. The Company maintains that derecognition of its deferred SFAS 87 pension expense regulatory asset would result in serious negative consequences to Idaho Power. At a minimum, the Company contends it would be forced to write off the $33 million balance of deferred SFAS 87 pension expense (as of September 30, 2009). Idaho Power's equity would also likely decrease by $92 million in addition to the retained earnings impact of derecognizing the regulatory asset for deferred pension expense. Both of these accounting changes could have negative impacts on customers.

STAFF REVIEW

Staff has reviewed the Company's Application and the accompanying testimonies of Ken Petersen and Timothy Tatum, along with the records of Case No. IPC-E-03-13 resulting in Order

No. 29505 and Case No. IPC-E-07-07 resulting in Order No. 30333 as both were referenced by the Company. Staff's comments are intended to provide the Commission with additional background regarding the Company's treatment of pension expense, the purpose and effects of the Company's Application as well as additional concerns regarding the Company's Application. Ultimately Staff will recommend that the Commission deny the Company's request for the proposed pension expense tracker. Recovery of pension expense continues to be appropriately dealt with during the course of a rate case. Staff will support a reasonable amortization of actual deferred cash contributions. This recovery method will meet the requirement of SFAS 71 to recover the deferral balance in future rates. The amortization can change as needed to recover the remaining deferral balance of actual cash contributions.

Statement of Financial Accounting Standards No. 87 was issued by the Financial Accounting Standards Board in 1987 to, among other things, provide a consistent basis for which publicly traded companies accounted for pension expense. Prior to 1987, companies had a variety of options when recording pension expense making it difficult for users of financial statements to adequately compare the expenses, and thus earnings, of one company to another. The Company implemented the statement by accruing the Net Periodic Pension Cost, as calculated under SFAS 87 and synonymous with SFAS 87 Expense, as an expense on the income statement, while contributing the minimum required cash contributions as calculated under the Employee Retirement Income Security Act of 1978 (ERISA). The difference between those two calculations is significant.

Following the Company's 1994 general rate case, the first general rate case since the implementation of SFAS 87, the Company began recovering from customers $2,036,000 annually for pension expense. The Company's pension expense under SFAS 87 was actually $3,040,000, however only $2,036,000 was expensed. The remaining $1,003,200 was capitalized as overhead labor, allowing the Company to receive an annual return on the remaining amount plus the annual depreciation expense associated with the pension expense included in capitalized overhead. The Company's treatment of pension expense was not contested in the 1994 general rate case and Staff and the Commission were silent on the issue.

In Idaho Power's next general rate case (Case No. IPC-E-03-13) increasing pension expense, among other reasons, was cited as the main driver for the need to raise rates. Although Idaho Power states in its current Application that it included the accrued SFAS 87 pension expense in the IPC-E-03-13 case, it was actually Idaho Power that initially proposed to abandon

SFAS 87 for ratemaking purposes, requesting an additional $2,170,160 in pension expense by suggesting that Service Cost is a more appropriate measure of expense to be recovered from customers. This proposal was made even though the Company was not permitted to contribute any cash to the plan under Department of Labor Pension Guidelines for the previous eight years and for several years into the foreseeable future due to a significant over-funding originating from better than anticipated market returns over the prior decade. It wasn't until after Staff pre-filed direct testimony arguing against Idaho Power's proposal that the Company retracted the proposal. Staff's testimony in that case detailed the differences between Net Periodic Pension Cost as calculated under SFAS 87, Service Cost, and the cash contribution range between the Required Minimum Contribution and Maximum Deductible Contribution. *See*, Tr. At 1496-1509. The Commission agreed with Staff's recommendation in the case and ordered that the Company be allowed to recover only the amount it had actually contributed to the pension plan during the test year, which was $0.00.

Because Idaho Power is now required to make annual cash contributions to the pension plan which may vary dramatically in amount, the Company is now seeking authorization to implement a defined benefit pension expense tracking mechanism to guarantee that Idaho Power recovers in its annual revenue no less than 100% of the actual cash payments made by the Company to fund the plan. The proposed tracking mechanism would be similar to the Power Cost Adjustment mechanism in that it would include a forecast component and a true-up component. Under the proposed mechanism, the Company would recover through rates its forecasted annual cash payments toward defined benefit pension expense based upon an actuarial determination of those anticipated required contributions. Each year, the Company would compare the revenue collected through the tracking mechanism's forecast component rate with the actual cash contributions to defined benefit pension expense during the period. Any difference would either be refunded or collected from customers over the subsequent 12-month period in the true-up component.

Staff generally prefers traditional regulation to cost trackers, limiting the use of cost trackers to extraordinary circumstances where it can be proven that a tracking mechanism is in the best public interest. Generally speaking, cost trackers, especially those with forecasts, can undercut the incentive to deter utility waste and promote cost efficiencies. Cost trackers also shift business risk from the utility and place it squarely upon the shoulders of the customers.

However, in recognizing that situations do exist whereby a cost tracker may be necessary, Staff applies three distinct criteria to review a tracking mechanism:

1) The expense is largely outside the control of the utility;
2) The expense is unpredictable and volatile, and;
3) The expense is substantial and recurring.

The choice to sponsor and adopt a defined benefit pension plan over other available retirement plan alternatives is a choice that is made solely by the management of a utility. The benefit formulas that calculate the projected benefits an employee will receive upon retirement, the actuarial assumptions regarding expected return on plan assets, turnover rates, and future pay increases are all established with management input and have a significant effect on the amount of contributions that are required each year.

Furthermore, a defined benefit pension plan by nature, already places economic risk upon utility customers. The primary element of a defined benefit plan is that the benefit upon retirement is defined, thereby placing all the investment risk upon the employer. When the employer is a regulated utility that recovers the retirement expense through rates, then that risk is shifted to the customers. If a cost tracking mechanism is established that guarantees that a utility will be able to recover 100% of all contributions to a defined benefit pension plan, then all the economic, financial, and investment risk is borne by the customers of that utility. With the shift in risk from the utility to the customers, a corresponding decrease in return on equity would need to be evaluated.

The third criteria used by Staff to determine if a cost tracker is in the public interest is whether or not the expense is substantial and recurring. Though pension expense can be substantial and recurring, the differences between the test-year cost and the actual cost must have a material effect on the utility's rate of return. With the approved deferral accounting treatment, the difference will be minimal. In Idaho under traditional ratemaking, known and measurable adjustments to test year expenses are recognized to account for expenses that will occur beyond the test year. Any under recovery or over recovery of pension costs will not likely have a material impact on the utility's rate of return. For these reasons, Staff does not believe that the above criteria necessary to establish a tracking mechanism for pension expense have been met.

In supporting its argument for the implementation of a pension expense tracking mechanism, the Company contends that SFAS 71 requires a tracking mechanism because of the previously deferred SFAS 87 pension expense arising from Commission Order No. 30333 in

Case No. IPC-E-07-07. In that Case, Idaho Power requested authorization to account for pension expense on a cash basis, i.e. remove SFAS 87 pension expense from its financial statements and to record it as a regulatory asset. Furthermore, Idaho Power requested authority to defer any future cash contribution to the pension plan.

In that case, Staff was concerned with the requirements of SFAS 71, the accounting standard that would allow the Commission to approve any deviations from generally accepted accounting principles (GAAP). SFAS 71 provides that before costs which would otherwise be expensed can be capitalized or deferred, it must be probable that the regulating entity will allow recovery of prudently incurred amounts in future rates. The concerns with the requirements of SFAS 71 in that case were discussed with the Company before proposing a solution that both the Company and Staff agreed would satisfy the requirements of SFAS 71. Staff stated in its filed written comments in that case:

> Over the life of a pension plan, the amount of SFAS 87 pension expense and the amount of cash contributions are theoretically equivalent and without interference, the SFAS 87 expense and the cash contributions over time will be comparable. Therefore, to address Staff's concerns about SFAS 71, Staff believes it would be permittable to allow the deferral of SFAS 87 pension expense as a regulatory asset if the cash contributions when made are credited as an offsetting entry to that regulatory asset. Given the presumption that the two expenses will ultimately be equivalent and the regulatory asset account will zero out on its own, then the SFAS 71 requirements will be satisfied.

The Company's reply comments also confirm that the requirements of SFAS 71 will have been met "if the Commission concurs that it is reasonable to assume that the Company's actual cash contributions to its defined benefit pension plan are reasonable expenses for ratemaking purposes, then the Company and its outside auditors can reasonably conclude that it is probable that the Commission will allow recovery of prudently incurred cash contributions in future rates."

During the course of the IPC-E-07-7 proceedings, Staff had frequent communications with Idaho Power regarding SFAS 71 and future recovery of pension contribution in rates, whenever the time came that the Company was again required to fund the pension plan. At that time, Staff informed the Company that it was not supportive of a tracking mechanism. In that case, the Company never contested that the requirements of SFAS 71 will not be met.

In the current filing, Idaho Power now contends that without a tracking mechanism, the Company will no longer be able to apply the SFAS 71 methodology to the deferral of SFAS 87 pension expense, requiring it to derecognize approximately $33 million, the balance of the regulatory asset account created by the deferral of SFAS 87 pension expense as of September 30, 2009. The Company also contends that it would be required to derecognize an additional $92 million in equity related to the accumulated other comprehensive income (AOCI) in the equity section of the balance sheet for SFAS 158. SFAS 158 requires the Company to record a liability for its unfunded projected benefit obligation, which is defined as the difference between the market value of the plan's assets and the actuarially determined projected benefit obligation. The accounting entries to record the unfunded projected benefit obligation also include a corresponding decrease, net of deferred taxes, in the AOCI on the balance sheet.

SFAS 71 states that before a utility can capitalize or defer a cost that would have otherwise been expensed, two conditions must be met. The first condition is that it must be "probable that future revenue in an amount at least equal to the capitalized cost will result from the inclusion of that cost in allowable costs for rate-making purposes." The footnotes of the statement define the term probable with its "usual general meaning, rather than in a specific technical sense, and refers to that which can be reasonably expected or believed on the basis of available evidence or logic but is neither certain nor proved." The second criteria of SFAS 71 states that "Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs."

Staff's assertion in Case No. IPC-E-07-07 still holds true today. Because the agreed upon accounting entries in that case use the cash contribution as an offset to the regulatory asset created by deferral of SFAS 87 pension expense, and because over time, the cash contributions and the accrued pension expense under SFAS 87 will be similar, the regulatory asset will trend towards zero. SFAS 71 only requires that it will be probable that future revenues will be allowed to recover the capitalized cost, a specific recovery mechanism is not dictated. With amortization of the deferred cash contributions and because the capitalized cost will tend to zero out over time, it is more than probable that future revenues will be allowed to recover those costs.

Staff applies the same logic to the second criteria of SFAS 71 because future revenue will be provided to permit the recovery of the previously incurred cost. Staff continues to believe that the deferral of cash contributions and the amortization of those costs in rates through the normal ratemaking process is an appropriate recovery mechanism. It meets the requirements of SFAS 71 and allows the Company to recover reasonably incurred pension costs. An additional tracking mechanism is not necessary. Staff believes a mechanism with forecast and true-up provisions is inappropriate for these expenditures. The three criteria for a tracking mechanism discussed above have not been met. Staff would support a reasonable amortization period of actual deferred balances. As stated by the Company in its IPC-E-07-07 reply comments, page 9 "…a carrying charge rate and amortization period for the deferred expense associated with the cash contributions would be determined in a future proceeding." To restate, Staff does not believe the cost tracker meets this intent, nor is the proposed cost tracker necessary or appropriate.

STAFF RECOMMENDATION

After reviewing the Company's Application and all other available information, Staff recommends that the Commission deny the Company's request for the proposed pension tracking mechanism. In doing so, Staff recommends that the Commission reaffirm its commitment in Order No. 30333 that reasonable and prudently incurred cash contributions based on the ERISA minimum funding requirements may be properly included in the Company's revenue requirement. Staff also recommends that the Company be allowed to recover in a future rate case a reasonable amortization of the deferred balance associated with the cash contributions of its defined benefit pension plan after the costs are actually incurred and deferred.

Respectfully submitted this 14th day of January 2010.

Scott Woodbury
Deputy Attorney General

Technical Staff: Donn English
Terri Carlock

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 14TH DAY OF JANUARY 2010, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. IPC-E-09-29, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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