BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF IDAHO POWER COMPANY'S REQUEST TO MODIFY RECOVERY OF INCENTIVES PAID TO SECURE DEMAND-SIDE RESOURCES.	)))))	CASE NO. IPC-E-10-27

IDAHO POWER COMPANY

DIRECT TESTIMONY

OF

JOHN R. GALE

Q. Please state your name and business address.

A. My name is John R. Gale 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 Senior Vice President of Corporate Responsibility.

Q. Please describe your educational background and business affiliations.

A. I received a BBA in 1975 and an MBA in 1981 from Boise State University. I maintain a close affiliation with the University and serve as Vice Chair of the College of Business and Economics' Advisory Council. I have also attended the Public Utilities Executive Course at the University of Idaho and am on the faculty of that program leading the section on "Regulation and Ratemaking."

I am the immediate past chair of the Edison Electric Institute's ("EEI") Rates and Regulatory Affairs Committee, which is the committee that is concerned primarily with regulatory issues and ratemaking methods. I am also a member of EEI's Retail Energy Services Executive Advisory Committee, which engages in emerging electric energy issues and advises the membership's Chief Executive Officers.

Q. Please describe your work experience.

A. From 1976 to 1983, I was employed by the State of Idaho primarily as an analyst in the Department of Employment. In October 1983, I accepted a position at Idaho Power as a Rate Analyst in the Rate Department. In March 1990, I was assigned to the Company's Meridian District Office where I held the position of Meridian Manager, which was a one-year cross-training position established to provide corporate employees with an extensive field experience.

I returned to the Rate Department in March 1991 and in June, I was promoted to Manager of Rates. In July 1997, I was named General Manager of Pricing and Regulatory Services. In March 2001, I was promoted to Vice President of Regulatory Affairs, where I oversaw and directed the activities of the Pricing and Regulatory Services Department and had the primary responsibility for policy matters related to the economic regulation of Idaho Power. I have testified frequently before the Idaho Public Utilities Commission ("Commission") on a variety of rate and regulatory matters. I have also testified before or submitted direct testimony to the regulatory commissions in Nevada and Oregon, the Federal Energy Regulatory Commission ("FERC"), the Bonneville Power Administration, and the

United States Senate Committee on Energy and Natural Resources. In total, I led Idaho Power's regulatory activities for nineteen years.

In May 2010, I was promoted to Senior Vice President of Corporate Responsibility. My duties in this capacity include developing a corporate sustainability program and reporting activity, managing various state and regional issues (including the Bonneville Power Residential Exchange Program), forging large load/economic development policy, and implementing the business model of demand-side resources.

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

A. My purpose is to provide a comprehensive policy discussion on the subject of demand-side resources ("DSR"). Often, the complete picture of a DSR business model gets lost in piecemeal program, prudency, and rate filings. My testimony will cover all regulatory aspects in one telling. My testimony will describe the importance of DSR to the resource portfolio, why utilities are good delivery vehicles for DSR programs, the regulatory conundrum of approving DSR expenditures, the necessary regulatory/business model for DSR, where the points of

contention are among the Company and the various parties, and Idaho Power's plan to address these issues.

Q. What is your experience related to energy efficiency activities at Idaho Power?

A. During my career at Idaho Power, I have been responsible for numerous regulatory filings related to energy efficiency programs and their recovery mechanisms. This experience covers two full cycles of the development and implementation of a complete suite of energy efficiency programs. One cycle began in the late 1980s and culminated with a 1997 case (IPC-E-97-12), which dealt with the cost recovery of these energy efficiency expenditures by Idaho Power. The results of IPC-E-97-12 combined with the emerging electric industry restructuring phenomenon led to eventual dismantling of the Company's energy efficiency effort. Under the restructuring paradigm, the market would be the provider of all needed resources, both demand and supply side. The dramatic impacts of the 2000/2001 Western Energy Crisis ultimately exposed the flaws in "the market will provide it" concept and set the Company on course to reinvigorate its Integrated Resource Plan ("IRP") and rebuild its energy efficiency capability.

Following the Western Energy Crisis, both the Idaho Commission and the Company have moved to restore and

enhance the energy efficiency effort at Idaho Power, ushering in the second energy efficiency cycle. From a complete cold start, Idaho Power's DSR activities have progressed to the point where the Company now has a full and robust suite of energy efficiency and demand response programs and is spending nearly 5 percent of its revenues on these activities. Among the successes are the institution of the Energy Efficiency Advisory Group, the Energy Efficiency Rider funding mechanism, the Fixed Cost Adjustment decoupling mechanism, the prudency Memorandum of Understanding, the energy efficiency incentive workshops, the build-out of a complete suite of programs for all customer classes, along with the growth in annual energy efficiency savings from 19,000 MWh in 2004 to 148,000 MWh in 2009 and the installation of demand response capacity of approximately 290 MW in 2010.

Q. Please elaborate on the first build-out of energy efficiency programs at Idaho Power.

A. Prior to the 1990s, conservation programs played a relatively small role in Idaho Power's overall resource acquisition strategy. The Company began to actively pursue conservation activities in the late 1970s; however, these efforts tapered off in the mid-1980s with the economic slowdown and continuing surplus of energy in

the Pacific Northwest. It was during the early 1990s that Idaho Power first adopted a focused, substantial and increasingly active approach to the development of DSR with its customers. Demand-side programs became an integral part of the Company's IRP, smaller pilot-type programs transitioned to more comprehensive system-wide efforts, and significant commitments of Company personnel and financial resources were required.

In January 1994, Idaho Power prepared a policy paper titled "The Pursuit of Demand-Side Management" and adopted a philosophy to pursue all demand-side activities that are cost-effective on a total resource cost basis, while limiting any detrimental impact on the Company's competitive position, its customers, and its shareholders. This concerted effort produced significant results. During the ten years from 1990 to 2000, Idaho Power operated approximately twelve programs in all customer sectors (plus several pilots) and initiated participation in the Northwest Energy Efficiency Association ("NEEA") in 1997. The Company spent just over $41 million during those ten years and saved a cumulative 26 average megawatts. The Company at that time was in an energy deficit position; therefore, the program focus was on purchasing energy

efficiency resources; demand response programs were not implemented at that time.

Q. How were these programs funded?

A. This generation of energy efficiency programs was built upon the concept that a DSR ought to be treated in the same manner as a supply-side resource, including the manner in which expenditures were recovered in rates. Thus, operating and maintenance ("O&M") expenses were included in base rate expenses and investments in demand-side measures were capitalized, amortized over time, and earned a rate of return on the unamortized asset. Because the investments were as a practical matter not under the direct ownership and control of the Company, they were established as regulatory assets and received their value based upon the Commission order authorizing them.

Q. How did this model work when it was time to request rate recovery?

A. Unfortunately, the model did not work well for Idaho Power. The concept had substantial merit; however, the applied result was financially painful to Idaho Power. Notwithstanding, I firmly believe that demand-side resources should be treated the same as supply-side resources, which is a recurring theme throughout my testimony.

There were some tough lessons in this first energy efficiency build-out and its resulting regulatory treatment. Prudency issues surfaced with disallowances in both the ongoing O&M and in the regulatory assets themselves, which caused the Company to take write downs on its energy efficiency business activities. Some of the prudency issues surfaced from misunderstandings between the Company and the Commission. One example of this tension pertained to the area of commercial lighting where Company and Staff debated the requisite program evaluations necessary to be sufficient to establish cost recovery. Ultimately, it took several dockets to resolve this issue.

Other problems (from Idaho Power's standpoint) with the first effort included lowering the rate of return from the overall rate (including equity) to a debt rate, thus relegating the demand-side an inferior investment to supply-side resources for the Company. In my opinion, both the reduced return and the energetic pursuit of disallowances were a symptom of a bigger problem with the original concept, which, in my view, was that the regulatory assets simply stayed on the books too long. The amortization period used created long-lived assets, thus creating large carrying charge obligations. While the original intent was to marry the regulatory assets to the

useful lives of the demand-side measures, the practical effect was to inflate the regulatory asset balance with accumulated carrying charge costs. I believe this impact alarmed both the Staff and the Commission at the time of the IPC-E-97-12 proceeding.

Q. How does Idaho Power view DSR today?

A. Cost-effective DSR (energy efficiency and demand response programs) is the Company's resource of choice – both from a cost standpoint and from an environmental perspective. The cleanest, most efficient resource in the Company's portfolio is the one it does not have to build. The Company believes that cost-effective DSR should be pursued aggressively and that funding should not unduly impede its acquisition. Otherwise, Idaho Power's customers are ultimately left with the higher cost "pay me later" position when the Company must subsequently acquire higher cost resources to match customer loads.

Q. Is this view shared by other Idaho energy stakeholders?

A. Yes. It is as close to a universally held opinion as I believe there is among our stakeholders. Company, customer groups, regulators, the environmental community, and public policy advocates endorse the acquisition of cost-effective DSR for both its economic

advantage and its mitigation of many of the environmental and cost risks facing the industry today. As energy efficiency and demand response programs have matured, their value as a resource has become more apparent, tangible, and readily accepted.

Q. You mentioned customer groups have supported the acquisition of cost-effective DSR. How have individual customers responded to the Company's energy efficiency efforts?

A. Customers have a generally favorable view of energy efficiency programs as expressed through direct customer interaction and customer satisfaction surveys. However, when the Company has a filing before this Commission regarding energy efficiency, often the input is negative. I attribute this much more to some customers' general frustration with rate matters than to actual dissatisfaction with energy efficiency programs.

Q. What are the benefits of the Company directly providing DSR as opposed to a third-party administrator?

A. A chief benefit is the integration of the DSR with supply-side resource options for short-term resource operations, intermediate-term risk management, and long-term resource planning through the IRP. This

integration helps ensure that this resource is acquired in an economic, reliable, and environmentally responsible manner. For Idaho Power this means that the optimum demand-side measure is implemented in terms of resource characteristics (peak or energy reduction). A second prime benefit is the positive contact and interaction with Idaho Power customers. It creates the opportunity for customers to "save twice" – once directly through reduced consumption and twice through the acquisition of lower-cost resources. Engaged customers are key to the effectiveness of DSR.

Another benefit is the additional discipline exercised in a regulatory environment where the Company's actions and expenditures are transparent and overseen by this Commission to better assure the cost-effective acquisition of demand-side resources.

Q. With all this support for the acquisition of demand-side resources, how does it compare to the Company's other activities in the area of regulatory treatment?

A. That is the conundrum. Cost-effective energy efficiency is identified as the resource of choice by virtually all stakeholders, yet demand-side resources are faced with the most challenging regulatory scrutiny for cost recovery. The challenges are more formidable than the supply-side counterpart and include elevated prudency

evaluation standards, protracted proceedings, overcoming the fixed cost recovery disincentive, asymmetric risk and reward propositions, and no earnings opportunity thus far.

Q. What are the necessary regulatory components of a successful DSR business activity?

A. There are five primary components. First, there must be clear and achievable guidelines for prudency. Second, there must be a timely recovery of out-of-pocket expenditures that appropriately recognizes the time value of money and does not negatively impact cash flow in a significant way. Third, the economic disincentives to reduce load must be removed via better pricing, decoupling, or some other mechanism that does not strand fixed cost recovery. Fourth, the Company must have the ability to earn on the energy efficiency investments just like any other business activity in which the Company is engaged. And finally, there must be a forum established for customers and other stakeholders to have direct involvement in the selection and development of programs. At Idaho Power, the Energy Efficiency Advisory Group performs this role.

Much like Maslow's hierarchy of human needs, these components have a hierarchy or progression of importance. Accordingly, that is why stranded fixed costs and a

potential earnings opportunity have emerged as issues subsequent to making regulatory progress on determination of prudency and timely out-of-pocket cost recovery.

Q. Please identify the current issues that need to be addressed regarding the regulatory treatment of DSR expenditures.

A. There are a number of important issues that I believe would be helpful to resolve in order to further the pursuit of cost-effective DSR. These include: (1) a more straightforward approach to prudency determination; (2) solidifying the Fixed Cost Adjustment mechanism; (3) optimizing Idaho Power's participation in third-party initiatives, such as the Northwest Energy Efficiency Alliance, the Northwest Regional Technical Forum, the Integrated Design Lab in Idaho, and other state and regional efforts to advance energy efficiency research and market transformation; (4) addressing the growing Energy Efficiency Rider negative balance (and its subset of issues); and (5) implementing a realistic earnings opportunity for Idaho Power's investments in DSR.

Q. How does the Company's plan address these concerns?

A. In summary, Idaho Power will continue to advocate for its view of the proper regulatory/business

model in existing forums and in new filings. My testimony lays out the foundation for comprehensive action. The Company seeks Commission affirmation that DSR is a valuable resource properly managed and delivered by Idaho Power. In addition, Idaho Power will continue to be engaged in activities that ensure that a DSR prudency determination is a more prescriptive, prospective, and objective process. I am hopeful that the Memorandum of Understanding worked out with the Commission Staff will ultimately provide the guidance that can be relied upon by the regulator and the regulated. It is not the Company's intention to escape the consequences of poor management or imprudent action, but it is Idaho Power's intention to put the prudency test on par with other Company business activities.

Q. Please discuss the challenge of implementing an effective mechanism to remove the disincentive to reduce load.

A. The concept is target rich for mischief and misinformation with several national entities willing to oblige. The slogan, "Save more, pay more" has been well used, if not well supported. Additionally, there continues to be confusion surrounding the removal of a disincentive versus the role of an incentive, where some advocate that

the removal of the disincentive itself should carry with it the demonstration of additional demand-side performance.

For Idaho Power, the benchmark for successfully removing the disincentive is to obtain a result similar to what it might achieve if rate design reflected the fixed costs of service. The Company understands that a fundamental pricing change is problematic from a policy standpoint at this time. Nevertheless, it is the fixed cost exposure that creates the disincentive. Idaho Power continues to advocate for the removal of disincentives through its Fixed Cost Adjustment (decoupling) mechanism.

Q. Are there other efforts Idaho Power can pursue to optimally acquire demand-side resources?

A. A comprehensive approach to demand-side resource acquisition necessitates a broad scope of efforts. In Idaho Power's case, this approach starts with its solid support of codes and standards and continues with its strong offerings of mature energy efficiency and demand response programs, as well as its participation in regional market transformation efforts. This direct involvement in acquiring DSR can be leveraged by building capability into the service territory infrastructure through education, knowledge building, and research. Currently, Idaho Power is building an effective education initiative to increase

awareness among its customers; however, more can be done in other education sectors. Idaho Power is in a unique position to encourage innovation and knowledge building in this area.

While the bulk of the monetary resources to fund a comprehensive approach must be focused on cost-effective program deployment, these acquisition efforts can be enhanced by allowing a portion of the budget to be allocated to other capability building efforts. These efforts include education, innovation development and even local research.

In order to achieve an optimal reduction in overall load from Idaho Power's customers, an infrastructure must be developed to build knowledge about energy efficiency, to train the local workforce, and to encourage the use of local innovation to solve Idaho specific issues.

Q. Please describe Idaho Power's concerns regarding the funding of third-party research and regional transformation activities.

A. Idaho Power's primary concern is optimizing the return for investing in these activities on behalf of its customers. As evidenced in the Company's NEEA filing before the Commission earlier this year, there is increased demand for funding, which Idaho Power is diligently trying

to manage. Idaho Power expects additional pressure to assist in the funding of worthwhile energy efficiency research and workforce development opportunities. Idaho Power's objective going forward will increasingly be to see those dollars spent in its service territory and benefitting its customers.

Q. What are the proposed changes to the Company's Energy Efficiency Rider?

A. New actions include proposals to address the growing negative balance in the Energy Efficiency Rider ("Rider"), including the proposals requested in this filing. The problem with a Rider with an extended negative balance is the symmetry is broken and the mechanism becomes a drag to the Company's cash flow. The current Rider balance is negative over $16 million at this writing and has been negative since April 2008. The large negative balance reflects both a success story and a challenge. It is a success because the growing balance is indicative of increasing programs, expenditures, and savings in DSR. However, continuing to increase the amount is problematic. The Company believes there is a more appropriate path that would allocate some of the expenses to more suitable alternatives for recovery. These actions are: (1) moving demand response incentive payments into the Power Cost

Adjustment ("PCA") on a prospective basis beginning on June 1, 2011, and (2) establishing a regulatory asset for the Custom Efficiency program through Commission order.

Q. Please describe the Company's request related to demand response incentive payments.

A. The Company is requesting authority to remove the incentive payments for all the Company's demand response programs and transfer 100 percent of these costs to the PCA on a prospective basis. My colleague, Darlene Nemnich, supports such a proposal in her direct testimony in this case. Currently, the demand response programs include the A/C Cool Credit Program for residential customers, the Irrigation Peak Rewards program for irrigation customers, and the FlexPeak Management program for commercial and industrial customers. The impact of this change will not be seen until next summer, but the magnitude of the funds not collected through the Rider will be significant over the 2011 air-conditioning and irrigation seasons and will act to reduce the negative Rider balance. Table 2 of Idaho Power's Exhibit No. 1 indicates estimated demand response incentive payments of nearly $13.7 million in 2011 and $14.5 million in 2012.

Q. Please describe the Company's request related to capitalizing energy efficiency incentive payments.

A. The Company's second request is to seek an order from the Commission authorizing the Company to capitalize the direct incentive payments for one energy efficiency program as a regulatory asset to enable the Company to earn a return on some of its DSR activities. The requested program is Custom Efficiency applicable to commercial and industrial customers.

Q. What makes this program suitable to become a regulatory asset?

A. The program incentives are material, the investments are for the most part tangible, and the benefits received are among the best of the Company's programs. Materiality is important because of the administration necessary to account for and track the investments and to obtain a return amount sufficient to make the exercise worthwhile. Custom Efficiency incentive payments are estimated to be approximately $5.2 million in 2011 and $5.6 million in 2012 (Table 2, Exhibit No. 1). The investments made under Custom Efficiency tend to be in tangible assets (i.e., lighting upgrades and motor rewinds), which have a better nexus to a capitalized item

even if the assets are not ultimately owned by the utility. Finally, the Custom Efficiency program has a high Utility Benefit/Cost Ratio of 5.37 and Total Resource Benefit/Cost Ratio of 2.05 over the lifetime of the program. It is important to the Company that the first regulatory asset request is a program with a proven record of delivering customer and Company benefits.

Q. When does the Company propose to start booking incentive payments to the regulatory asset accounts?

A. The Company requests that the regulatory assets be authorized for transactions on and after January 1, 2011.

Q. What is the Company's recommended amortization period?

A. The Company recommends a four-year amortization period for the capitalized balance, which would commence coincident with when rates become effective. The four-year amortization period strikes a balance between the need to recover balances quickly and the recognition of the regulatory asset.

Q. What is the Company's recommended rate of return for these assets?

A. Idaho Power recommends that the then current Commission authorized rate of return apply. This action will keep the DSR assets on par with the supply-side assets and can adjust over time as the Commission sets the return to reflect changing circumstances.

Q. Are you aware of any other programs in the region that capitalize energy efficiency programs?

A. Yes. In 2004, the Nevada Legislature passed revisions to the Nevada Administrative Code ("NAC") that allowed utilities to earn the authorized return on equity plus 5 percent for prudent and reasonable conservation and demand-side resource investments. These investments included the costs for labor, overhead, materials, incentives, advertising, marketing, and evaluation, as well as approved costs associated with monitoring and evaluating programs for conservation and energy efficiency through a general rate case. Further revisions to the NAC allowed utilities or the Commission to designate a facility as a "critical facility" for the purpose of protecting reliability, developing renewable energy resources, and promoting price stability. If the Commission designated a facility as a "critical facility," a utility could request that incentives related to the facility be included in rates. Incentives could include earning an enhanced return

on equity, inclusion in rates of construction work in progress and the ability to designate the costs incurred to construct the facility as a regulatory asset.

Since the passing of the legislation, Sierra Pacific and Nevada Power, being on mandated three-year rate cycles, have filed multiple general rate cases successfully requesting recovery of DSR-related expenditures under the program described. However, as the Nevada utilities experienced significant growth and success in DSR and energy efficiency activity, it became apparent that the 5 percent adder no longer served to compensate for lost revenue. Accordingly, the State passed new regulations in 2009, effective August 1, 2010, that allow for the annual collection of conservation expenditures via a PCA-type mechanism which sets a base program rate that includes an authorized return on equity, an allowance for lost revenue, and has a true-up component. The Nevada utilities plan to make their first filing under the recently adopted rules this fall.

Q. Is this treatment consistent with the Stipulation entered into by Idaho Power and other parties and approved by this Commission in Case No. IPC-E-09-30 on January 10, 2010, which provided that Idaho Power not file a general rate case to change its revenue requirement and

resulting rates to become effective prior to January 1, 2012?

A. Yes it is. Through this request the Company is not asking for a general rate change, but is only adjusting the PCA and changing the inputs to the Rider, both of which are specified exceptions to the rate moratorium as provided under Section 5.2 of the Stipulation.

Q. What are the benefits of the Commission approving regulatory asset treatment for the Custom Efficiency program?

A. Approving the creation of a regulatory asset for the Custom Efficiency program, like moving the demand response incentive payments into the PCA, relieves pressure to increase the Rider percentage again and provides a means to implement a key component of the regulatory model – the opportunity to earn on key business investments. This action begins to better align the risk/reward proposition for energy efficiency activities.

Q. Is Idaho Power requesting any additional changes related to ratemaking for energy efficiency at this time?

A. Yes. Because of the large negative balance existing in the Energy Efficiency Rider and because it will

take almost two years to work this balance down given the prospective nature of the Company's previously stated requests, Idaho Power requests that the Commission authorize the carrying charge on the remaining balance to move to the Company's authorized rate of return (currently 8.18 overall rate of return with a 10.5 return on equity component) instead of the interest rate on customer deposits (currently 1.0 percent). Changing the current carrying charge will become even more important should the Commission decide against part or all of the Company's requests.

Q. What would be the cumulative result of implementing the Company's plan?

A. The positive results include the DSR business model would be fully implemented, DSR would be treated as a resource in the same manner as the supply-side resources, and there would be the potential to lower the Rider percentage in the future.

Q. And what would be the consequence if these actions are not implemented?

A. The Company would be placed in the uncomfortable position of having to request another increase in the Rider to clear that account in the near term. Absent the requested enhancements to the Rider

mechanism and/or an increase to the Rider percentage, Idaho Power's collective goal of pursuing all cost-effective DSR will be in jeopardy.

Q. Why not just keep raising the Rider percentage to bring down the negative balance?

A. As Ms. Nemnich testifies, clearing the negative balance in one year would require a 7.5 percent Energy Efficiency Rider, which would be undesirable in today's economic environment. Even taking through 2012 to clear the balance would require a 6.6 percent Rider. Additionally, a rising percentage creates some perception issues with Idaho Power's customers. One problem is that its separate designation on the bill creates a focus on its relative percentage and amount. While that may be viewed as a good thing from a transparency perspective, it is problematic because not all business activities are so identified and the isolation brings unwarranted scrutiny. Moreover, continued funding solely from the Rider designates the regulatory treatment of DSR as different from the rest of the Company's business functions. In addition, Idaho Power believes the Rider is inappropriate for demand response capacity payments, which would be better reflected in power supply expenses.

Q. Earlier you indicated a Company preference for an earnings opportunity based upon capitalized regulatory assets. What specifically would Idaho Power propose?

A. Capitalization puts DSR on the same footing as supply-side resources, but an amortization consistent with the life of the measure has created some problems as the cumulative carrying charges overtake original investments. Idaho Power would propose a much quicker amortization of the DSR Regulatory Assets – no more than four years with amortization beginning with the start of rate recovery.

Q. Please summarize your testimony.

A. Cost-effective, demand-side resources are highly desirable in a carbon-constrained world. Idaho Power is uniquely positioned to optimize the delivery of DSR programs. While most agree that the pursuit of DSR is a worthy endeavor, the current business model makes it inferior to investments on the supply side. Idaho Power recommends specific actions that can bring the DSR to an equal footing, including the proposals made in this Application. A robust and healthy business model for energy efficiency will provide for the optimal procurement

of cost-effective, demand-side resources and is a matter of substantial customer benefit and good public policy.

Q. Does this conclude your testimony?

A. Yes.