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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR AUTHORITY TO IMPLEMENT RATES TO INCLUDE CAPITALIZED CUSTOM EFFICIENCY INCENTIVE PAYMENTS.	**CASE NO. IPC-E-12-24** **COMMENTS OF THE 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 Application and Notice of Modified Procedure issued in Order No. 32682 on November 20, 2012, submits the following comments.

BACKGROUND

On October 31, 2012, Idaho Power Company filed an Application requesting Commission authorization to place in rates a portion of a regulatory asset account created for capitalized custom efficiency incentive payments. Idaho Power's custom efficiency program provides financial incentives to commercial and industrial customers to implement energy efficiency measures, including motor rewinds, variable frequency drives, energy efficient refrigeration, and others. In an earlier case, Idaho Power proposed to capitalize direct incentive payments associated with its custom efficiency program. Case No. IPC-E-10-27. The Commission did not approve the Company's request to allow capitalization of incentive

payments, but did authorize the Company to account for custom efficiency incentive payments as a regulatory asset beginning January 1, 2011. Order No. 32245, p. 6.

In Order No. 32667 recently issued in Case No. IPC-E-12-15, the Commission stated that the interest rate to be applied to the incentive payment balance, which ultimately would be included in rates, should be thoroughly reviewed and determined in a rate case. Order No. 32667, p. 11. The Company in that case argued that its current rate of return should apply. *Id.* The Commission deferred a decision on the interest rate to be applied to the regulatory asset account until the Company seeks to recover the deferral balance in a general rate proceeding. *Id.* Idaho Power now proposes that the Commission allow recovery of custom efficiency incentive payments outside of a general rate case proceeding.

The Company proposes in this case to recover in its base rates the custom efficiency regulatory asset associated with incentive payments made in 2011 plus accumulated carrying charges. Incentive payments made in 2011 totaled $7,018,385, and the Company calculated a carrying charge using its authorized rate of return. Accordingly, Idaho Power proposes to recover a balance as of May 31, 2013 of $8,126,504. The Company proposes to apply its current authorized rate of return to the unamortized balance of the regulatory asset and to recover the investment through a four-year amortization schedule. This results in an annual revenue requirement of $2,949,340. The Company proposes to collect this additional revenue requirement through a uniform cents-per-kilowatt-hour charge, identified in a new tariff Schedule No. 56. Idaho Power also proposes to update Schedule 56 on an annual basis with an effective date of June 1 each year.

STAFF REVIEW

Staff has reviewed the Company's Application and accompanying testimony and exhibits of Matthew Larkin. Staff believes that Idaho Power has not provided any justification to change the Commission's three prior orders stating that recovery of the regulatory asset associated with the Company's Custom Efficiency DSM program and the carrying charge accrued to that regulatory asset should be determined in a general rate proceeding. Staff recommends that the Commission reject the Company's Application. Staff's comments in this case provide the Commission with additional background information, discuss concerns with the Company's proposal, and identify issues that need to be further vetted during a general rate proceeding.

This case is the culmination of several cases in which the Company has attempted to create a more profitable business model for its Demand-Side Management programs. These Comments address the relevant issues in each of those cases.

IPC-E-10-27 -- Investigation of Cost Recovery Mechanisms for Energy Efficiency Programs

On October 22, 2010, Idaho Power filed an Application with the Commission requesting the Commission to accept the Company's proposed business model for acquiring demand-side resources (DSR). The parties signed a stipulated settlement that allowed Idaho Power to recover incentive payments for the Company's three demand response programs through the annual Power Cost Adjustment (PCA) mechanism and capitalize the incentive payments for the Company's Custom Efficiency program. The Custom Efficiency program regulatory asset would have been amortized over seven years and includes a carrying charge equal to the Company's approved rate of return. The Stipulation represented a compromise by all parties, however, the Industrial Customers of Idaho Power (ICIP) refused to sign the Stipulation based, in part, on disagreements over the amortization period and cost allocation issues. The Commission rejected the Stipulation.

Staff's support for the Stipulation was predicated on the large and growing balance in the Company's DSM rider account. At the time, the rider account had an approximate negative balance of $17 million. Without any action, the deficit balance was projected to grow to a negative $30 million in 2012. Staff was cognizant of the Company's need for timely recovery of DSM expenditures and was willing to negotiate a compromise position that would reduce the rider balance.

On April 1, 2011, the Commission issued Order No. 32217 rejecting the Stipulation. The Commission stated that "the specific proposals, however, raise issues and concerns that are more properly vetted in a rate case. Expenditures that are expected to be included in rate base, or that are included in the PCA after determining a normalized cost for customer base rates, present issues of concern for all customers." The Commission further expressed its anticipation of reviewing proposals to adjust DSM cost recovery in Idaho Power's next rate case. Order at 5.

On April 22, 2011, Idaho Power filed a Petition for Clarification because the Commission's Order was silent with regard to the Stipulation's proposed treatment of the Custom Efficiency program incentives as a regulatory asset with a seven-year amortization

period. The Company stated, incorrectly, that "the sole point of disagreement between the parties was with regard to the length of the amortization period." Petition at 5. This statement was contested by ICIP in its Answer to the Petition. ICIP further argued that to grant the Company's request without addressing the cost-of-service issues "would be a failure to address all of the relevant issues regarding whether the Company's proposal can be workable." ICIP Answer at 8.

The Commission allowed Idaho Power to establish the regulatory asset account as of January 1, 2011. Establishing a regulatory asset account for the incentives paid through the Custom Efficiency program did not change current customer rates. The Commission noted that its Order did not presume recovery of any amount without appropriate program cost reviews, and that the amortization period would be determined after those reviews.

IPC-E-12-15 – Determination of 2011 DSM Expenditures

On March 15, 2012, Idaho Power filed an Application to determine that the 2011 DSM expenditures were prudently incurred, including $7,018,385 of Custom Efficiency incentive payments. Staff reviewed the payments and concurred with the Company that the payments were prudent. However, Staff and the Company disagreed on a carrying charge for the regulatory asset. In Order No. 32667, the Commission stated it "believe[s] the interest rate to be applied to the balance – and ultimately included in rates – concerns all customers and should be thoroughly reviewed and determined in a rate case." Order at 11. The Commission found it "reasonable to defer deciding the interest rate to be applied to the Custom Efficiency Program regulatory asset account, and the resulting interest amount, until the Company seeks to recover the deferral balance in a general rate proceeding."

Nothing has changed since Order No. 32667 was issued on October 22, 2012. The Commission has consistently expressed its intent to determine these issues in the context of a general rate proceeding. Nevertheless, the Company filed this Application to seek recovery outside of a general rate case just nine days later. Staff recommends the Commission reject the Company's Application and issue another Order reiterating that the various issues of concern to all parties are best vetted during a general rate proceeding.

Amortization Period

In addition to Staff's support for previous Commission directives to resolve issues surrounding capitalization of regulatory assets in a general rate case, Staff has concerns about the Company's specific proposals regarding the carrying charge and amortization period. The Company prudently incurred $7,018,385 in Custom Efficiency incentive payments during 2011 and booked that amount as a regulatory asset. The Company's Application requests that it earn the full authorized rate of return (currently 7.86%) on the regulatory asset and begin amortization over four years beginning on June 1, 2013.

Staff believes the well-known Matching Principle applies in this case. The Matching Principle is a fundamental concept of accounting where expenses for an accounting period should be matched with the revenue generated in that same period. When the Matching Principle is applied to fixed assets, depreciation expense applied to the asset is determined and matched with the projected life of the asset. The same would hold true for the Custom Efficiency program and its amortization expense in order to have treatment similar to supply-side resources.

The Company calculates the cost-effectiveness of its Custom Efficiency program based on a 12-year program life, which is intended to replicate as closely as possible the useful life of the energy efficiency measures installed through the program. The Company proposes to amortize the annual expenses of this program over just four years. Determining the amortization period for this regulatory asset is understandably difficult because the Company does not retain ownership of the physical assets installed through the Custom Efficiency program. Without ownership in the tangible assets, the Company does not retain a marketable salvage value on its books. The Company argues that it is appropriate to amortize the non-tangible book asset over a shorter period to account for the increased risk of capitalizing intangible assets and chooses a four-year amortization without providing any specific evidence of its appropriateness.

Carrying Charge

The Company believes it should be allowed to reduce its risk in its Demand-Side Resource investment by amortizing annual expenses over a period much shorter than the useful life of the program, but continues to argue for its full rate of return to earn a profit on its investment. This Commission has reduced the amortization period associated with capitalized DSM assets, but also reflected a corresponding decrease to the carrying charge on those assets. In Case No. IPC-E-97-12, Idaho Power filed an Application requesting the amortization period

of the then-capitalized DSM assets be shortened from 24 years (useful life) to 5 years. The Commission stated in the Final Order in that case (Order No. 27660) that it found "it would be consistent and reasonable for us to consider the reduction in risk attributable to a shorter DSM recovery period in selecting a carrying charge. Because we have decided to allow the Company to shorten the DSM recovery period to 12 years, we find that a carrying charge of 7.25% based on utility bond rates would be appropriate." Order at 10. At the time, the Company's rate of return was 9.199% with a Return on Common Equity of 11%, compared to its current rate of return of 7.86%.

In that same case, the Company argued against singling out the interest on deferred DSM balances without a full assessment of all factors impacting the Company's risk. By that same principle, other parties argued that it is inappropriate to accelerate the recovery of DSM without netting it against all of Idaho Power's resources. All parties seemed to agree that these issues were best resolved during the course of a general rate case, which further supports Staff's recommendation in this case, and the Commission's consistently stated position.

Demand-Side Resources vs. Supply-Side Resources

Company Witness Larkin states that "the primary objective of the Company's request is to establish a ratemaking methodology that places investment in this demand-side resource (DSR) on equal footing with investment in supply-side resources from a business evaluation perspective." Direct Testimony at 2. While Staff recognizes the inherent differences between demand-side and supply-side resources, Company witness Larkin believes that DSR is inferior to supply-side resources, simply because it does not allow the Company profit without capitalization. The Company has claimed that if the Commission were to allow it to earn profits on DSR, it would be more willing to invest in DSR. This claim cannot be substantiated. Providing the Company profit on its DSR investments will cause ratepayers to pay more for those resources while not changing the Company's overriding incentive to invest in supply-side resources. Further, Commission Orders directing the Company to pursue all cost-effective DSM were not contingent on the Company being able to earn a return on those investments.

The Company argues that it is necessary to place DSR on equal footing with supply-side resources, but then cherry picks the accounting treatment for supply-side resources that would provide a financial benefit for its DSM program, and ignores the accounting treatments that do not benefit it financially. For example, supply-side resources begin depreciating immediately

upon being placed in service, but the Company proposes to begin amortization of the DSM regulatory asset each year on June 1st. Allowing the DSM investment to accumulate and earn a carrying charge before beginning amortization provides the Company with undue profits and does not align with supply-side resource depreciation practices. If the regulatory asset account were to be treated the same as supply-side resources, the Company would begin amortizing projects immediately upon completion, rather than booking those assets and allowing them to earn a carrying charge for up to a year before amortization and recovery in rates.

Utilities regularly invest in supply-side resources between rate cases. The undepreciated investment is not included in rate base until the conclusion of a general rate case, at which point the Company earns a return. Of course, the Company decides when it will file a rate case.

Mr. Larkin quotes the testimony of Company witness Gale in Case No. IPC-E-10-27 stating that one component of a successful DSR business model would be "the ability to earn on the energy efficiency investments just like any other business activity in which the Company is engaged." Not all of the Company's business activities include the ability to earn a return. The Company has invested in numerous Purchase Power Agreements (supply-side resources) without earning a return. Demand-side resources, treated as an annual expense, are already on equal footing with many supply-side resources from a cost-recovery standpoint.

Other Concerns

One of Staff's primary concerns with the Company's proposal is that it unduly places shareholder profits above customers' best interests. The Company paid $7 million in Custom Efficiency incentives, yet with carrying charges proposes to collect over $8 million beginning on June 1, 2013. Grossed up for taxes, customers would pay over $2.9 million per year, which is approximately $12 million over the proposed four-year amortization period. Staff believes it is unreasonable for customers to pay $12 million for an annual expense of $7 million, as they would under the Company's proposal. The primary reason Staff accepted the Stipulation filed in Case No. IPC-E-10-27, was because the Company was not receiving timely recovery of its investments in DSM. Through actions taken by this Commission, the rider account balance has gone from a negative $17 million at the end of 2010 to a surplus balance of $2.4 million on September 30, 2012. The Company is currently receiving more revenue through the DSM rider than it spends. At this point, the Company would actually receive more timely recovery of its

investment in the Custom Efficiency program if it were paid through the rider and not capitalized.

The Company stated that cost-effective demand-side resources are the Company's resource of choice – both from a cost standpoint and from an environmental perspective. Given its admission that DSR is the resource of choice for all stakeholders, and the directive of this Commission to pursue all cost-effective DSM, Staff believes it is inappropriate to provide the Company extraordinary customer-funded incentives for operating a program that it has already been operating successfully for years without this incentive.

Single-Issue Ratemaking

Staff believes the Company's proposal constitutes single-issue ratemaking. The Commission has approved single-issue rate cases in the past, but only for significant investments such as a new power plant closely following a general rate case. When the Company makes significant investments in generation, a single-issue rate case may be appropriate to allow recovery of the new generation plant without the scrutiny of a general rate case. The Company's investment in the Custom Efficiency program is not significant enough to qualify for that special treatment by the Commission.

STAFF RECOMMENDATION

Staff recommends that the Commission reject the Company's Application to establish a ratemaking methodology with annual adjustments to recover DSM incentive payments. Staff supports the Commission's previous directives that the issue of recovery and carrying charge is best suited for a general rate case.

Respectfully submitted this 22nd day of January 2013.

Weldon B. Stutzman
Deputy Attorney General

Technical Staff: Donn English

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 22ND DAY OF JANUARY 2013, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. IPC-E-12-24, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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