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Idaho Public Utilities Commission  
Office of the Secretary  
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NOV 9 - 1990  
Boise, Idaho

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION )  
OF IDAHO POWER COMPANY FOR )  
AUTHORITY TO RATE BASE THE )  
INVESTMENT REQUIRED FOR THE )  
REBUILD OF THE SWAN FALLS )  
HYDROELECTRIC PROJECT )  
\_\_\_\_\_ )

CASE NO. IPC-E-90-2

DIRECT TESTIMONY OF DON READING, PH.D.  
ON BEHALF OF THE INDUSTRIAL CUSTOMERS OF IDAHO POWER

NOVEMBER 9, 1990

1 Q. WOULD YOU PLEASE STATE YOUR NAME AND ADDRESS?  
2 A. Don Reading, 1311 North 18th Street, Boise,  
3 Idaho 83702.  
4 Q. DO YOU HAVE AN APPENDIX THAT DESCRIBES YOUR  
5 EDUCATIONAL AND OCCUPATIONAL HISTORY AND YOUR  
6 QUALIFICATIONS IN REGULATORY AND UTILITY  
7 ECONOMICS?  
8 A. Yes. Appendix I, attached to my testimony,  
9 was prepared for this purpose.  
10 Q. DO YOU HAVE AN EXHIBIT WHICH SUPPORTS YOUR  
11 TESTIMONY?  
12 A. Yes. I have an exhibit consisting of one  
13 schedule which was prepared under my  
14 supervision.  
15 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?  
16 A. Our firm was retained by the Industrial  
17 Customers of Idaho Power (ICIP) to -examine  
18 the request of Idaho Power Company (Idaho  
19 Power or the Company) for rate basing of the  
20 reconstruction costs associated with the  
21 reconstruction of the Swan Falls powerhouse  
22 and generating facilities. My testimony has  
23 three sections. First, I review the Company's  
24 request and my concerns. Second, I present

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1 the Commission with suggestions concerning  
2 assigning a value to the Swan Falls project.  
3 Third, I summarize my recommendations and  
4 conclusions.

5 Q. LET'S TURN TO THE FIRST SECTION OF YOUR  
6 TESTIMONY. WOULD YOU PLEASE DESCRIBE THE  
7 COMPANY'S REQUEST?

8 A. Certainly. The Company is proposing to expand  
9 its generating facilities at Swan Falls.  
10 Although this reconstruction does not require  
11 that the Company obtain a Certificate of  
12 Public Convenience and Necessity before  
13 reconstruction begins, it must submit to a  
14 review of the rebuild by the Commission. In  
15 its Application concerning this review the  
16 Company is also requesting that the Commission  
17 approve rate base treatment for the project  
18 before reconstruction begins. In return for  
19 this preapproval, the Company agrees to "cap"  
20 the capital cost of the project at  
21 \$80,285,000, barring several uncertainties.

22 The Company is proposing to retire the  
23 existing 10.4 Mw powerhouse at Swan Falls and  
24 redevelop the project to include a new

1 powerhouse with two generating units totaling  
2 25 Mw of capacity, a new switchyard, and a new  
3 transmission line, together with certain  
4 existing project works. [Application, p. 2.]

5 In its Application the Company states  
6 that Swan Falls should be added to rate base  
7 upon completion of reconstruction. The  
8 Company further describes the purported  
9 benefits of the project as follows:

10 The Project has been, and will  
11 continue to be, integral to  
12 Idaho Power's Snake River  
13 hydroelectric system and will  
14 continue to be used to serve  
15 retail and firm wholesale load.  
16 Reconstruction of the Swan Falls  
17 facilities is also integral to  
18 retention of Idaho's water  
19 resources for the public  
20 interest of the state. The  
21 Project is a non-deferrable  
22 resource in that the physical  
23 state of the plant requires  
24 current, not future,

1 reconstruction and  
2 rehabilitation of the resource  
3 to maintain safety and  
4 operational standards.

5 [Application, p. 4.]

6 Similarly, the Company points out that  
7 the water rights associated with Swan Falls  
8 are critical to the ability of the state and  
9 the Company to protect the minimum flows  
10 established by the Swan Falls Agreement and  
11 the Water Plan. Protection of the Company's  
12 rights at Swan Falls has the effect of  
13 assuring a water supply at its downstream and  
14 upstream plants. [Application, p. 5.]

15 While I do not dispute the importance  
16 of these water rights, they should not be used  
17 as the sole basis for justifying the more than  
18 \$80,000,000 in reconstruction expenditures and  
19 a doubling of the size of the Swan Falls  
20 facility. The reasonable costs that  
21 legitimately should be passed on to ratepayers  
22 and the need for the Company to retain its  
23 water rights are in many aspects separate  
24 issues.

1 Q. HAS THE COMMISSION ISSUED ANY ORDERS THAT GIVE  
2 DIRECTION WITH RESPECT TO THE COMPANY'S  
3 DECISION TO REBUILD SWAN FALLS?

4 A. Yes, it has. In Order No. 19623, issued in  
5 Case No. U-1006-240 on April 24, 1985, the  
6 Commission warned:

7 We put Idaho Power on explicit  
8 notice, however, that before it  
9 undertakes any substantial  
10 reconstruction or replacement of  
11 the Swan Falls facility, other  
12 than improvement or  
13 reconstruction of the existing  
14 spillway, it must first  
15 demonstrate to this Commission  
16 in a formal proceeding that the  
17 project is the least-cost method  
18 of acquiring a new resource for  
19 its system. [Idaho Public  
20 Utilities Commission, Order No.  
21 19623, p. 1.]

22 In addressing the above language in a  
23 subsequent Order the Commission noted that it  
24 required Idaho Power "to bring any rebuild of

1 the Swan Falls project and increase in its  
2 capacity to the Commission's attention in much  
3 the same manner that it would file a  
4 certificate for a new project." [Idaho Public  
5 Utilities Commission, Order No. 23380, p. 2.]  
6 The Commission further cautioned Idaho Power:

7 We put Idaho Power on formal  
8 notice that it acts under its  
9 own peril for costs associated  
10 with the Swan Falls rebuild  
11 until such time as the Company  
12 is prepared to submit its  
13 definitive cost estimate and to  
14 demonstrate that the project  
15 will be cost-effective. As we  
16 stated in the -197 case, the  
17 year of "hell-or-high-water-  
18 financing" is over. The  
19 ratepayer should not be at risk  
20 if management commences  
21 construction before it receives  
22 a definitive cost estimate, or  
23 before it has an approved water  
24 right, or if it fails to study

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reasonable alternative projects,  
or if the project itself is not  
cost-effective compared to power  
that is readily available from  
competitors. [Idaho Public  
Utilities Commission, Order No.  
19623, quoting Order No. 19129.]

The Commission has clearly warned the  
Company that its decision to rebuild the Swan  
Falls project and the costs of that rebuild  
will be critically examined.

Q. DO YOU BELIEVE THAT THE INFORMATION PROVIDED  
BY THE COMPANY IS AN ADEQUATE RESPONSE TO THE  
COMMISSION?

A. No, I do not. The Company has provided very  
little evidence in its Application concerning  
the cost effectiveness of the Swan Falls  
project and has not shown that the project is  
the least-costly alternative available to  
ratepayers. While I do not dispute the many  
benefits of hydro projects over other forms of  
generation, I do not believe these benefits  
should automatically be the basis upon which  
one determines the prudence of the project.

1 Likewise, I understand the importance of the  
2 water rights associated with the Swan Falls  
3 project. This nevertheless should not be used  
4 as the sole basis for determining that the  
5 Company's decision to rebuild Swan Falls is  
6 reasonable. Instead, water rights should be  
7 one of many factors examined by the Company  
8 and the Commission when assessing the Swan  
9 Falls rebuild decision and its associated  
10 costs.

11 The Company has not presented evidence  
12 showing that the reconstruction of the Swan  
13 Falls project is less costly than installation  
14 of demand-side management measures. Moreover,  
15 the Company has not presented any evidence  
16 concerning the need for this project.

17 Numerous other questions concerning the  
18 reconstruction remain unanswered and would  
19 require thorough analysis on the part of Staff  
20 and interveners as well as the Commission  
21 before a final determination of prudence could  
22 be made. For example, the Company has not  
23 explained the rationale behind its 25%  
24 contingency factor--which is considerably

1 higher than the 5% contingency factor used for  
2 the Milner project. Satisfactory reasons for  
3 these differences may exist, but they have not  
4 been offered by the Company. Similarly, Idaho  
5 Power Company has not explained in sufficient  
6 detail the other components of its "commitment  
7 estimate." The Company has failed to provide  
8 information concerning the estimated cost per  
9 kwh of this project. Nor has it shown that  
10 the increase in the size of the project is  
11 optimal.

12 Another factor that I find troubling is  
13 the difference in the cost per kw of Swan  
14 Falls and Milner. The Company's estimated  
15 cost per kw of Swan Falls is \$3,244, which is  
16 almost three times as high as Milner at \$1,187  
17 per kw, and an alarming amount on its face.  
18 Again, there may be valid reasons for this  
19 difference, but they have not been advanced by  
20 the Company.

21 Q. DO YOU SEE ANY OTHER PROBLEMS WITH THE  
22 COMPANY'S REQUEST?

23 A. Yes. There are several serious problems with  
24 the Company's proposal. If the Commission

1 grants the Company's request for preapproval  
2 of the rate base treatment of Swan Falls, it  
3 will effectively foreclose its ability to  
4 examine the prudence of the Company's  
5 decision-making between the time  
6 reconstruction begins and the time the project  
7 is completed, even though major changes of  
8 circumstances might arise in the interim. For  
9 example, changes in load growth might dictate  
10 changes in the pace of construction of the  
11 project, either to meet increased load or to  
12 avoid installing excess capacity. Or  
13 technological progress might call for  
14 canceling the Swan Falls project and replacing  
15 it with a more cost-effective alternative. Or  
16 heightened environmental restrictions might  
17 impose an intolerable burden of added cost on  
18 the Swan Falls project, destroying its  
19 economic feasibility.

20 Any of these events, as well as others,  
21 should invite the Company to reevaluate its  
22 initial reconstruction decision and possibly  
23 reverse or modify it. Yet, under the  
24 Company's proposal, such events would be

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1           irrelevant to the determination of the plant  
2           costs to be included in rate base and paid for  
3           by ratepayers. Instead, that issue would be  
4           judged solely according to whether the Company  
5           had used "prudent and reasonable construction  
6           practices." If Idaho Power is deemed to have  
7           done so, it wants to be guaranteed that it  
8           will be allowed full recovery of the cost of  
9           the Swan Falls project, regardless of any  
10          economic, financial, technological,  
11          environmental, or regulatory events that might  
12          otherwise argue for alteration of the  
13          Company's initial decision.

14          Q.     DO YOU THINK THE COMMISSION SHOULD PREAPPROVE  
15                   THE FUTURE RATE BASE TREATMENT OF THE  
16                   RECONSTRUCTION COSTS OF SWAN FALLS?

17          A.     Definitely not. I see no reason for the  
18                   Commission to preapprove the future rate base  
19                   treatment of the reconstruction costs of Swan  
20                   Falls. The Company's position in this regard  
21                   is similar to the one it has taken concerning  
22                   the issuance of a Certificate of Public  
23                   Convenience for the Milner project. The  
24                   Company is asking the Commission to guarantee

1           that the project's costs will be automatically  
2           included in rate base regardless of the  
3           circumstances, as long as the Company uses  
4           "reasonable and prudent construction  
5           practices."

6                         This is not a defensible posture.   The  
7           Commission's authorization to begin  
8           reconstruction of Swan Falls is not a  
9           requirement that construction begin, nor an  
10          endorsement of the decision to begin  
11          construction.  A determination of the rate  
12          base treatment of the Swan Falls project  
13          should be made only after the project is  
14          completed and on line.  I don't believe that  
15          it is appropriate or in the public interest  
16          for the Commission to determine today the  
17          future rate base treatment of a project that  
18          has not begun reconstruction much less been  
19          completed.

20          Q.         ARE THERE OTHER UNCERTAINTIES ASSOCIATED WITH  
21                      THE SWAN FALLS PROJECT THAT WOULD PRECLUDE THE  
22                      COMMISSION FROM PREAPPROVING A RATE BASE CAP  
23                      FOR THE SWAN FALLS REBUILD?

1           A.       Yes. In its decision concerning Valmy II the  
2                   Commission stated that its statutory charge  
3                   was to "establish 'just and reasonable'  
4                   rates." [Idaho Public Utilities Commission,  
5                   Order No. 20610, p. 105.] That requires the  
6                   Commission to know the final just and  
7                   reasonable cost of the project. But it is  
8                   impossible for the Commission at this time  
9                   even to estimate the completed cost of the  
10                  Swan Falls project and its associated running  
11                  costs. There are at least two reasons for  
12                  this inability. First, the "cap" set by the  
13                  Company is contingent upon several favorable  
14                  predictions. That is, if inflation heats up  
15                  or the scope of the project changes, then  
16                  under the Company's proposal, its "commitment  
17                  estimate" would no longer hold as the cap for  
18                  the project's capital cost. (I discuss this  
19                  in greater detail below.)

20                         Second, while the Company itself can  
21                         only estimate the cost per kwh of the project,  
22                         it hasn't even provided that information to  
23                         the Commission.

1                   For these and other reasons, the  
2                   Company cannot accurately estimate the cost  
3                   per kwh of the Swan Falls project. Nor can  
4                   the Commission determine today that inclusion  
5                   of the capital cost of plant in rate base  
6                   would produce just and reasonable rates.

7           Q.       WHAT IS YOUR NEXT CONCERN ABOUT THE COMPANY'S  
8                   PROPOSAL?

9           A.       The Company has offered to treat what its  
10                   "commitment estimate" of the capital cost of  
11                   Swan Falls as a cap on the amount to be  
12                   preapproved for rate base. While the  
13                   Company's proposal has surface appeal, there  
14                   are several arguments, in addition to those  
15                   already discussed, against the Commission's  
16                   adopting the Company's quid pro quo.

17                               First, there no guarantee that the  
18                   proposed cap will be at or below the  
19                   commitment estimate. The Company notes that  
20                   it is willing to commit to building the  
21                   Project for less than the commitment estimate,  
22                   "as may be adjusted to account for documented  
23                   changes in escalation rates or scope."

1 [Application, p. 8.] The Company elaborated  
2 on what is meant by changes in scope:

- 3 1) Force Majeure or acts of God  
4 impacting the construction;  
5 2) Design optimization for which  
6 increased energy more than offsets the  
7 increase in initial investment;  
8 3) Foundation or site condition  
9 significantly more expensive than  
10 indicated by exploratory drilling.

11 [Ibid.]

12 The Company's reservations with respect  
13 to the cap do not guarantee the commitment  
14 estimate will be the upper bound of the amount  
15 of the plant that will be included in rate  
16 base. That is, little is left to affect the  
17 price of the plant that the Company has not  
18 already covered in its escalation and scope  
19 disclaimer.

20 Q. ARE THERE OTHER PROBLEMS WITH THE COMPANY'S  
21 CAP PROPOSAL?

22 A. Yes. First, the Company does not define  
23 adequately define what is encompassed in its  
24 escalation disclaimer. Conceivably, any

1           inflation costs above what is included in the  
2           commitment estimate would be grounds for the  
3           Company's adjusting its estimate upwards and  
4           including these increased costs in rate base.  
5           Yet, the Company doesn't explain the projected  
6           escalation rate included in its commitment  
7           estimate. Hence, the Commission cannot know  
8           whether the Company is working from a tight  
9           budget or an ample one.

10                        Second, the Company's expansive scope  
11           qualification can cover a multitude of  
12           factors. Suppose, for example, that the  
13           Company decides to increase the size of the  
14           project. Would it be fair to charge  
15           ratepayers for the additional costs without  
16           examining the Company's decision? But under  
17           the Company's proposal, such a change would  
18           presumably come within its definition of scope  
19           and hence not be subject to further review.

20           (It is noteworthy that many utilities involved  
21           in the construction of large nuclear power  
22           plants cited changes in scope as the source of  
23           a significant percentage of their cost  
24           overruns.)

1 Third, the Company's cap proposal is  
2 one-sided. The Company wants to increase the  
3 cap if major inflation occurs, but it does not  
4 offer to reduce the cap if inflation subsides  
5 and falls significantly below the escalation  
6 allowance included in the Company's commitment  
7 estimate. I see no reason for the Commission  
8 to agree to such an unbalanced arrangement.

9 Finally, Idaho Power does not explain  
10 how its proposed 25% contingency fits in with  
11 its escalation and scope adjustors. In  
12 response to Staff's First Production Request  
13 the Company stated that the 25% contingency  
14 "is not a derived mathematical computation"  
15 but is "based on experience." [Response to  
16 Staff's First Production Request, No. 15, page  
17 7.]

18 Generally, a contingency of this nature  
19 is included in a cost estimate to cover such  
20 factors as changes in scope and escalation.  
21 Hence the Company has not only covered its  
22 uncertainties with its scope and inflation  
23 disclaimers but has inserted an added  
24 substantial buffer in the form of a

1                   contingency in its commitment estimate. While  
2                   I am not opposed to the use of a contingency,  
3                   (it is common practice), the Commission needs  
4                   to realize how little risk the Company has  
5                   assumed with respect to its proposal. (I am  
6                   surprised that the Company has not included an  
7                   caveat for increases in borrowing costs, but  
8                   then again, this might be covered under the  
9                   Company's escalation limitation.)

10            Q.       WOULD YOU PLEASE DISCUSS YOUR NEXT CONCERN?

11            A.       Yes. The Company's proposal assigns most of  
12                   the risks of reconstructing Swan Falls to its  
13                   ratepayers while eliminating most of the  
14                   potential risks to its stockholders.  
15                   Ratepayers would shoulder all the following:  
16                   the risk of escalation of reconstruction  
17                   costs, the risk of increased scope, the risk  
18                   of load growth changes, the risk of  
19                   technological changes, the risk of poor  
20                   management decision-making (other than strict  
21                   construction prudence), the risk of  
22                   environmental changes, the risk of regulatory  
23                   changes, the risk that the project will not be

1 used and useful, and the risk that the project  
2 will not be economical.

3 Idaho Power's stockholders, on the  
4 other hand, would face only the risk that the  
5 Company would not use reasonable and prudent  
6 construction practices and the risk that some  
7 costs of the plant might not be allowed in  
8 rate base if the Company exceeded its cap.  
9 The latter risk is practically eliminated by  
10 the broadly defined escalation and scope  
11 reservations that accompany the Company's  
12 proposal. Clearly, while ratepayers would  
13 bear a great deal of risk, the stockholders  
14 would incur very little.

15 Even though the Company's request  
16 shifts most of the risks associated with the  
17 Swan Falls project to ratepayers, the Company  
18 has not offered to simultaneously reduce its  
19 cost of equity. In my opinion, if the  
20 Commission adopts the Company's proposal,  
21 which I strongly recommend against, it should  
22 also at a minimum reduce the Company's cost of  
23 equity below the Commission's last authorized

1 return of 12.25%. [Idaho Public Utilities  
2 Commission, Order No. 20924, p. 62.]  
3 Q. WHY WOULD ADOPTION OF THE COMPANY'S PROPOSAL  
4 CALL FOR A REDUCTION IN IDAHO POWER'S COST OF  
5 EQUITY?  
6 A. It is a basic financial principle that the  
7 greater a security's risk, the higher the  
8 investor's required return, and vice versa.  
9 If the Commission significantly reduces  
10 stockholder risk by adopting the Company's  
11 proposal, then it should reduce the Company's  
12 cost of equity. In Idaho Power's last rate  
13 proceeding, the Company's witness Mr. Bowers  
14 acknowledged this principle, testifying that  
15 "the greater a security's risk the higher the  
16 required return for that risk." [Bowers  
17 Direct Testimony, Case No. U-1006-265, p. 31.]  
18 Mr. Bowers also testified that a risk-free  
19 rate of return can be approximated by using  
20 the interest rate on long-term government  
21 bonds. [Ibid., p. 30.] Recently, long-term  
22 (30-year) U.S. Treasury Bonds have been  
23 carrying an interest rate of about 9.0%, which  
24 is significantly below the Company's

1 authorized return on equity. Under the  
2 Company's proposal, the equity risk supporting  
3 the Company's investment in the Swan Falls  
4 project would more closely approximate that of  
5 a government bond than of a security yielding  
6 12.25%, the Commission's last authorized  
7 return.

8 Q. CAN YOU ILLUSTRATE THE IMPACT OF EQUITABLE  
9 RATEPAYER TREATMENT, ASSUMING ACCEPTANCE OF  
10 THE COMPANY'S PROPOSAL?

11 A. Yes. Let us assume that the Company's  
12 investment in Swan Falls (and in the Milner  
13 project) is financed in the same proportion as  
14 the Company's capital structure, and that the  
15 investor's return requirement on the equity  
16 portion of this investment is approximately  
17 10% (one percentage point above the measure of  
18 a risk-free rate), this would indicate that  
19 the Company's cost of equity should be reduced  
20 by about a quarter of one percent (0.25%) to  
21 12.0%, using the Commission's last authorized  
22 return. I have depicted these calculations on  
23 my Schedule 1. The Company earned 13.86% on  
24 average equity during 1989. I therefore

1 recommend that the Commission, if it accepts  
2 Idaho Power's proposals in this case, it also  
3 investigate the Company's earnings situation  
4 and authorize a rate decrease, if one is seen  
5 to be warranted. Indeed, it appears that  
6 absent any such decrease, an earning  
7 investigation is called for.

8 Q. LET'S TURN TO THE SECOND SECTION OF YOUR  
9 TESTIMONY. WOULD YOU BRIEFLY DISCUSS WHAT THE  
10 COMMISSION SHOULD CONSIDER WHEN DETERMINING  
11 THE VALUE OF THE SWAN FALLS PROJECT ONCE IT IS  
12 COMPLETED AND ON LINE?

13 A. Certainly. Let me emphasize that the  
14 following suggestions apply only to a  
15 completed project that is ready for  
16 consideration for inclusion in rate base. I  
17 do not believe it is appropriate or in the  
18 public interest to predetermine the investment  
19 value of the Milner project at this time.  
20 Numerous events could intervene before the  
21 project enters commercial operation--events  
22 that could render unnecessary or erroneous any  
23 such determination made today.

1                   In evaluating a plant to enter rate  
2                   base, the Commission should study a variety of  
3                   factors of two kinds: those related to the  
4                   prudence of management's decision-making, and  
5                   those related to the economics of the  
6                   situation. The former include such things as  
7                   the reasonableness of the Company's decision  
8                   to begin construction of the project, the  
9                   reasonableness of the construction practices,  
10                  the reasonableness of feasibility studies  
11                  undertaken, etc. The latter include the  
12                  used-and-useful issue and the economic value  
13                  of the plant.

14                  In determining a plant's economic  
15                  value, the Commission should of course  
16                  consider an assortment of factors, but one  
17                  particularly useful method of validating total  
18                  cost is to compare the cost per kwh of the  
19                  project to the Company's avoided cost rate.  
20                  The latter should provide a upper limit on the  
21                  economic value of the project. In this  
22                  particular instance, however, there are  
23                  reasons for the Swan Falls project's coming in  
24                  below avoided cost: the dam exists, permits

1 have already been obtained, original  
2 engineering completed, and site preparation  
3 accomplished.

4 When evaluating the cost per kwh of  
5 Swan Falls versus avoided costs the Commission  
6 needs to ensure that the basis of the  
7 measurement is consistent. Only then can a  
8 appropriate evaluation be made as to the  
9 least-cost path of resource acquisition for  
10 the Company. For example, since avoided costs  
11 are determined over just a 20-year period,  
12 they are not consistent with the cost per kwh  
13 of Swan Falls, which is determined over a  
14 50-year period. All else being equal, a  
15 20-year avoided cost rate would be  
16 significantly less than a 50-year avoided cost  
17 rate. In addition, for comparison purposes, a  
18 20-year amortization of Swan Falls will  
19 produce a significantly more expensive plant  
20 than Idaho Power's current estimate for Swan  
21 Falls.

22 Other methods can also be used to  
23 determine the economic value of the plant.  
24 They include the amount of plant costs

1 reasonably incurred during the reconstruction  
2 of Swan Falls, the fair market value of the  
3 plant, and the cost of alternative forms of  
4 reliable power.

5           Regardless of what method is used, now  
6 is not the time to make this decision.  
7 Determining whether the plant should be  
8 included in rate base (and, if so, to what  
9 extent) can only be done after the project is  
10 completed and on line.

11       Q.       WOULD YOU PLEASE SUMMARIZE YOUR  
12               RECOMMENDATIONS AND CONCLUSIONS?

13       A.       Certainly. I believe the Commission should  
14 reject the Company's proposal for preapproval  
15 of the rate basing of the Swan Falls project.  
16 I do not believe it would be appropriate or in  
17 the public interest for the Commission now to  
18 determine the rate base treatment or  
19 regulatory status of a project on which  
20 reconstruction has not yet even begun. The  
21 Company's request has several serious flaws.

22               First, the Company's proposal should be  
23 rejected because it would require the  
24 Commission to ignore many relevant

1 circumstances that would otherwise force the  
2 Company to alter its initial course of action.  
3 The Commission would be barred from addressing  
4 the prudence of the Company's management  
5 decision-making process during the  
6 reconstruction period.

7 If the Commission adopts the Company's  
8 proposal for preapproval of the rate base  
9 treatment of Swan Falls, then it should reject  
10 the Company's application on the grounds that  
11 it is deficient. Many points relevant to a  
12 decision of this magnitude remain unaddressed  
13 by the Company. Idaho Power has not shown  
14 that the project is economical, nor that it is  
15 the least-cost alternative, nor that its  
16 enlargement is even needed. The Company has  
17 been previously warned about these factors,  
18 yet it has failed to provide information that  
19 would allow the Commission to evaluate the  
20 reasonableness of its decision.

21 Second, the Commission should not be  
22 lulled into thinking the Company's offer to  
23 cap the cost of the project is an adequate  
24 consideration for preapproval for the rate

1 base treatment of Swan Falls. The escalation  
2 and scope reservations attached to the  
3 Company's cap provide no guarantee that the  
4 final cost of the project will not exceed the  
5 commitment estimate. Rather, the escalation  
6 and scope give the Company considerable leeway  
7 in justifying increases in cost beyond the  
8 "commitment estimate." Moreover, the  
9 Company's cap proposal is one-sided. While  
10 the Company wants the Commission to agree to  
11 cost increases if the scope of the project  
12 enlarges or if escalation occurs, it has not  
13 proposed that the cap be adjusted downward  
14 under the converse circumstances.

15 Third, the Company's proposal saddles  
16 ratepayers with most of the risks of  
17 reconstruction, while eliminating most of the  
18 risks to shareholders. Despite this, the  
19 Company has not offered to lower its cost of  
20 equity. In my opinion, if the Commission  
21 adopts the Company's proposal to preapprove  
22 the rate base treatment of the Swan Falls  
23 project, it should adjust the Company's cost

1 of equity to be consistent with its reduced  
2 risk.

3 Finally, I have offered some  
4 suggestions concerning the factors the  
5 Commission should consider once the Swan Falls  
6 reconstruction is completed and its costs are  
7 considered for rate base treatment. Among  
8 them is a comparison of the cost per kwh of  
9 the project with the Company's avoided cost,  
10 establishing a reasonable upper limit on the  
11 economic value of the project. Other relevant  
12 data are the amount of plant costs reasonably  
13 incurred in the Swan Falls reconstruction, the  
14 fair market value of the plant and the energy  
15 it produces, and the cost of alternative forms  
16 of reliable power.

17 Q. DOES THIS COMPLETE YOUR TESTIMONY PREFILED ON  
18 NOVEMBER 9, 1990?

19 A. Yes, it does.

INDUSTRIAL CUSTOMERS OF IDAHO POWER  
CASE NO. IPC-E-90-2

SCHEDULE 1

IDAHO POWER COMPANY  
CHANGE IN COST OF EQUITY  
(000)

	<u>Amount</u>	<u>Ratio</u>
Common Equity	\$ 589,462	48.9%
Preferred Stock	58,923	4.9
Long-term Debt	<u>557,851</u>	<u>46.2</u>
	\$1,206,236	100.0%

Investment in Swan Falls and Milner	\$ 150,290	
Equity Ratio	<u>48.9%</u>	
Swan Falls and Milner financed by Equity	\$ 73,492	

	<u>Amount</u>	<u>Rate</u>		<u>Cost</u>
Swan Falls and Milner financed by Equity	\$ 73,492	x 10.00%	=	\$ 7,349
1989 Common Equity	<u>589,462</u>	x 12.25%	=	<u>72,209</u>
	\$662,954			\$79,558

Cost of Equity: \$79,558 / \$662,954 = 12.00%

Source: Idaho Power Company, 1989 Annual Report; Exhibit 3,  
Case No. IPC-E-90-8; Attachment 3, Supplemental  
Application, Case No. IPC-E-90-2; and Idaho Public  
Utilities Commission, Order No. 20924.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this 9<sup>th</sup> day of November, 1990, served the foregoing DIRECT PREPARED TESTIMONY OF DON READING ON BEHALF OF THE INDUSTRIAL CUSTOMERS OF IDAHO POWER, Case No. IPC-E-90-2, on all parties of record by hand delivering a copy thereof, to the following:

Michael S. Gilmore  
Brad M. Purdy  
Idaho Public Utilities Commission  
472 W. Washington  
Boise, ID 83720

and by mailing a copy thereof, postage prepaid, to the following:

Larry D. Ripley, Esq.  
Legal Department  
Idaho Power Company  
P.O. Box 70  
Boise, ID 83707

David H. Hawk, Director  
Energy Natural Resources  
J.R. Simplot Company  
P.O. Box 27  
Boise, ID 83707-0027

Steven L. Herndon, Esq.  
Legal Department  
Idaho Power Company  
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Boise, ID 83707

James N. Roethe, Esq.  
Pillsbury, Madison & Sutro  
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P.O. Box 27  
Boise, ID 83707-0027

Afton Energy, Inc.  
c/o Owen H. Orndorff  
Orndorff & Peterson  
1087 W. River St., Suite 230  
Boise, ID 83702-7035

BY Peter J. Richardson  
Peter J. Richardson

## APPENDIX I

### QUALIFICATIONS

#### Present Occupation

Q. WHAT IS YOUR PRESENT OCCUPATION?

A. I am a consulting economist with Ben Johnson Associates, Inc., a firm of economic and analytic consultants specializing in the area of public utility regulation.

#### Educational Background

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I graduated from Utah State University in 1962 with a Bachelor of Science degree in economics. I earned the Master of Science degree in economics at the University of Oregon in 1964. Finally, I received a Ph.D. in economics from Utah State University in 1972. The title of my doctoral dissertation was New Deal Expenditures in the 48 States, 1933-1939.

Q. HAVE YOU RECEIVED ANY ACADEMIC HONORS OR AWARDS?

A. Yes. I am a member of Omicron Delta Epsilon, the national economics honorary, and was awarded a National Science Foundation Fellowship in 1967.

#### Clients

Q. WHAT TYPES OF CLIENTS EMPLOY YOUR FIRM?

A. Much of our work is performed on behalf of public agencies at every level of government involved in utility regulation. These agencies include state regulatory commissions, public counsels, attorneys general, and local governments, among others. We are also employed by various private organizations and firms, both regulated and unregulated. The diversity of our clientele is illustrated below.

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Regulatory Commissions

Alabama Public Service Commission - Public Staff for Utility  
Consumer Protection  
Alaska Public Utilities Commission  
Arizona Corporation Commission  
Arkansas Public Service Commission  
District of Columbia Public Service Commission  
Idaho Public Utilities Commission  
Idaho State Tax Commission  
Kansas State Corporation Commission  
Maine Public Utilities Commission  
Missouri Public Service Commission  
North Carolina Utilities Commission - Public Staff  
Oklahoma Corporation Commission  
Ontario Ministry of Culture and Communications  
Texas Public Utilities Commission  
Virginia Corporation Commission  
Washington Utilities and Transportation Commission  
West Virginia Public Service Commission - Division of  
Consumer Advocate  
Wisconsin Public Service Commission

Public Counsels

Arizona Residential Utility Consumers Office  
Colorado Office of Consumer Services  
Connecticut Consumer Counsel  
District of Columbia Office of People's Counsel  
Florida Public Counsel  
Georgia Consumers' Utility Counsel  
Illinois Small Business Utility Advocate Office  
Indiana Office of the Utility Consumer Counselor  
Maryland Office of People's Counsel  
Minnesota Office of Consumer Services  
Missouri Public Counsel  
New Hampshire Consumer Counsel  
Ohio Consumer Counsel  
Pennsylvania Office of Consumer Advocate  
Utah Department of Business Regulation - Committee of  
Consumer Services

Attorneys General

Arkansas Attorney General  
Florida Attorney General - Antitrust Division  
Idaho Attorney General  
Kentucky Attorney General  
Michigan Attorney General  
Minnesota Attorney General  
Nevada Attorney General's Office of Advocate  
for Customers of Public Utilities  
South Carolina Attorney General  
Virginia Attorney General  
Washington Attorney General

Local Governments

City of Austin, TX  
City of Corpus Christi, TX  
City of Dallas, TX  
City of El Paso, TX  
City of Fort Worth, TX  
City of Galveston, TX  
City of Houston, TX  
City of Lubbock, TX  
City of Norfolk, VA  
City of Phoenix, AZ  
City of Richmond, VA  
City of San Antonio, TX  
City of Suffolk, VA  
City of Tucson, AZ  
County of Augusta, VA  
County of Henrico, VA  
County of York, VA  
Town of Ashland, VA  
Town of Blacksburg, VA  
Town of Pecos City, TX

Other Government Agencies

Canada - Department of Communications  
United States Department of Justice - Antitrust Division  
State of Florida - Department of General Services  
Provincial Governments of Canada

Regulated Firms

Americall LDC, Inc.  
E. Ritter Telephone Company  
Florida Association of Concerned Telephone Companies, Inc.  
Holywell, Inc.  
Louisiana/Mississippi Resellers Association  
Madison County Telephone Company  
Mountain View Telephone Company  
Nevada Power Company  
Network I, Inc.  
North American Telephone Company  
North Carolina Long Distance Association  
Pan-Alberta Gas, Ltd.  
Peninsula Communications, Inc.  
RDM Telephone Systems  
South Carolina Long Distance Association  
Stanton Telephone  
Teleconnect Company  
Transamericall, Inc.  
Yelcot Telephone Company, Inc.

Other Private Organizations

Arizona Center for Law in the Public Interest  
Casco Bank and Trust  
Citizens' Utility Board of Wisconsin  
Colorado Energy Advocacy Office  
East Maine Medical Center  
Georgia Legal Services Program  
Harris Corporation  
Interstate Securities Corporation  
J.R. Simplot Company  
Merrill Trust Company  
PenBay Memorial Hospital

**Prior Experience**

- Q. BEFORE BECOMING A CONSULTANT, WHERE WERE YOU PROFESSIONALLY EMPLOYED, AND IN WHAT CAPACITIES?
- A. From 1981 to 1986 I was Economist and Director of Policy and Administration for the Idaho Public Utilities Commission. My duties at the IPUC included, in addition to my testimony, the preparation of special reports in the areas of forecasting, demand studies, and economic analysis. As Staff Director I was charged

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with overseeing the personnel and budget functions, and with representing the Commission before the state legislature, at the governor's office, before the utility commissions of other states and before such federal and regional entities as the Bonneville Power Administration, the Northwest Power Planning Council, and the Public Power Council.

Before that time I taught economics at Middle Tennessee State University (Assistant Professor, 1968-70), Idaho State University (Assistant and Associate Professor, 1970-80), and the University of Hawaii at Hilo (Associate Professor, 1980-81). Subjects taught included economic theory and history, quantitative analysis, econometrics, statistics, labor economics, financial institutions, and international economics.

In addition, between 1970 and 1986 I prepared reports and expert testimony on loss of earnings in a number of legal actions respecting wrongful injury and wrongful death. Although many of these cases were settled without trial, I gave expert testimony in court on numerous occasions.

Q. HAVE YOU TESTIFIED PREVIOUSLY AS AN EXPERT WITNESS IN THE AREA OF PUBLIC UTILITY REGULATION?

A. Yes. I have provided or am preparing expert testimony on 19 occasions in proceedings before regulatory commissions in Alaska, California, Colorado, District of Columbia, Idaho, Nevada, Texas, Utah, and Washington, and before the Interstate Commerce Commission. In addition, I have served as a hearing examiner in Idaho.

My testimony in these proceedings dealt with electric power planning and forecasting, power supply models, avoided costs, demand elasticity models, regional economic conditions affecting public utilities, and cost of service.

Q. DO YOU HAVE ANY PROFESSIONAL PUBLICATIONS?

A. Yes. I have authored or co-authored more than 15 books and articles, including the following:

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"Post-PURPA views," Proceedings of the NARUC Biennial Regulatory Conference, September 1982.

An Input-Output Analysis of the Impact from Proposed Mining in the Challis Area (with R. Davies), Public Policy Research Center, Idaho State University, February 1980.

"The Paradox of Voting," Reason 10 (April 1979): 39- 41

"Index of Prices Received by Idaho Farmers," Idaho Economic Indicators, July 1978 (also continuing series published monthly).

"Income Distribution in Idaho Counties," Idaho Business and Economics Review.

Future-Gram, 'C' Series: Current Trends and Forecasts, 'C' Series (with R. Foster, et al.), Government Research Institute of Idaho State University and the Southeast Idaho Council of Governments, Pocatello, Idaho, June 1977.

An Empirical Analysis of Predictors of Income Distribution Effects of Water Quality Controls (with J. Keith, et al.), Utah Water Research Laboratory, Utah State University, Logan, Utah, September 1976.

Regional Growth and Fiscal Impact in Southeast Idaho (with V. Hjelm et al.), Government Research Institute of Idaho State University and the Southeast Idaho Council of Governments, Pocatello, Idaho, January 1976.

Phosphate and Southeast: A Socio Economic Analysis (with J. Eyre et al.), Government Research Institute of Idaho State University and the Southeast Idaho Council of Governments, Pocatello, Idaho, August 1975.

Estimating General Fund Revenues of the State of Idaho (with S. Ghazanfar and D. Holley), Center for Business and Economic Research, Boise State University, June 1975.

"Pocatello/Bannock County Economic Impact through 1978" (with R. R. Johnson), funded by the City of Pocatello (A Regional Input-Output Model), December 1975.

"A Note on the Distribution of Federal Expenditures: An Interstate Comparison, 1933-1939 and 1961-1965," American Economist 18, no. 2 (Fall 1974): 125-128.

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"New Deal Activity and the States, 1933-1939," Journal of Economic History 33 (December 1973): 792-810.

"Utah's Steel Industry" (with Reid R. Durtschi and Bartell Jensen), Utah State University Research Paper, 1965.

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ERRATA SHEET OF  
DON READING, Ph.D.  
BEFORE THE IDAHO PUBLIC SERVICE COMMISSION  
Case No. IPC-E-90-2

TESTIMONY

<u>Page</u>	<u>Line</u>	<u>Change From</u>	<u>Change To</u>
6	5	April 24, 1985	April 23, 1985
15	9	treat what its	treat its
15	17	there no	there is no
16	8	condition	conditions
16	22	does not define	does not
24	6	include	includes
24	11	include	includes