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IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE

IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR AUTHORITY TO INCREASE ITS INTERIM AND BASE RATES AND CHARGES FOR ELECTRIC SERVICE.	)))))))))	**CASE NO. IPC-E-03-13**

DIRECT TESTIMONY OF DONN ENGLISH

IDAHO PUBLIC UTILITIES COMMISSION

FEBRUARY 20, 2004

Q. Please state your name and business address for the record.

A. My name is Donn English. My business address is 472 W. Washington, Boise, Idaho 83702.

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

A. I am employed by the Idaho Public Utilities Commission (Commission) as an auditor in the accounting section.

Q. What is your educational and experience background?

A. I graduated from Boise State University in 1998 with a BBA degree in Accounting. Following my graduation I accepted a position as a Trust Accountant with a pension administration, actuarial and consulting firm in Boise. As a Trust Accountant, my primary duties were to audit the day-to-day financial transactions of numerous qualified retirement plans. In 1999 I was promoted to Pension Administrator. As a Pension Administrator, my responsibilities included calculating pension and profit sharing contributions, performing required non-discrimination testing and filing the annual returns (Form 5500 and attachments). In May of 2001, I became a designated member of the American Society of Pension Actuaries (ASPA). I was the first person in

Idaho to receive the Qualified 401(k) Administrator certification and I am one of only nine people in Idaho with the Qualified Pension Administrator certification. In 2001 I was promoted to a Pension Consultant, a position I held until 2003 when I joined the Commission Staff.

With the American Society of Pension Actuaries, I served on the Education and Examination Committee for two years. On this committee I was responsible for writing and reviewing exam questions and study materials for the PA-1 and PA-2 exams (Introduction to Pension Administration Courses), DC-1, DC-2 and DC-3 exams (Administrative Issues of Defined Contribution Plans - Basic Concepts, Compliance Concepts and Advanced Concepts) and the DB exam (Administrative Issues of Defined Benefit Plans). I have also regularly attended conferences and training seminars throughout the country on numerous pension issues.

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

A. The purpose of my testimony is to present Staff's position regarding the pension adjustments found in Idaho Power's filing. These three adjustments will reduce the pension expense to $0.00 to correspond with the actual contributions funded by Idaho Power. I will also present Staff's adjustment to specific miscellaneous expenses that Staff believes should not be recovered from ratepayers. Such expenses include various membership and association dues, political party donations and assorted expenses discovered after a careful review of management expense reports. I will also discuss Staff's adjustments regarding legal fees paid for advice and representation pertaining to alleged trading improprieties. Finally, I will present Staff's adjustments to variable interest rates that reduce the revenue requirement and the cost of capital.

Q. Why are there three adjustments to pension expense?

A. While Staff believes Idaho Power should not recover anything for pension expense, we also disagreed with some of their methodologies when calculating pension expense. I will present each of these adjustments separately, but ultimately, the pension expense for rate purposes should be $0.00.

Q. Are you sponsoring any Exhibits?

A. Yes, I will be sponsoring Exhibit Nos. 108-112.

Q. Will you please describe Exhibit No. 108?

A. Exhibit No. 108 consists of 5 pages and displays the historical trends of the Retirement Plan of

Idaho Power Company (pension plan). I will describe this Exhibit in more detail when presenting Staff's adjustments.

OVERVIEW OF COMPANY'S RETIREMENT PLANS

Q. Will you please describe the pension plan?

A. Idaho Power Company sponsors a traditional defined benefit pension plan. Participants will receive a monthly income upon retirement that is based on their years of service and their final average earnings. This plan is fully funded by Idaho Power Company. Assets in the plan are secured in a trust and guaranteed by the Pension Benefit Guaranty Corporation.

Q. Is this the only retirement plan sponsored by Idaho Power Company?

A. No, Idaho Power also sponsors a 401(k) plan called the Idaho Power Company Employee Savings Plan (ESP plan).

Q. Please describe the ESP plan.

A. The ESP plan is a defined contribution plan that allows Idaho Power employees to contribute to a 401(k) plan on either a pre-tax or post-tax basis to supplement their retirement. The assets are invested in funds chosen by the employee and the employee bears all of the investment risk.

Idaho Power Company provides matching

contributions to this plan equal to 100% of the first 2% of pay contributed, and 50% of the next 4% of pay contributed. So if an employee contributes 6% if their pay into the plan, they will receive a matching contribution of 4 percent.

Q. Does Idaho Power offer any other retirement plans to employees?

A. Yes, for certain individuals. Idaho Power sponsors the Security Plan for Senior Management Employees, the Executive Deferred Compensation Plan, the Long-Term Incentive and Compensation Plan for Officers and Senior Managers, and the Executive Incentive Plan. With the exception of the Executive Incentive Plan, Idaho Power appropriately charges contributions to these plans below the line and the costs are not recovered from ratepayers.

Q. Does Staff believe that ratepayers should pay the expenses and contributions for the Executive Incentive Plan?

A. No. Idaho Power is requesting recovery of the normalized level of costs of the Executive Incentive Plan in the amount of $5,114,821 from ratepayers, as displayed in Company witness Smith's Exhibit No. 19, page 2 of 6, line 9. Because the compensation packages received by Idaho Power's employees and management is already very generous, Staff believes any additional benefit to executives should also be booked below the line. The pension plan and the ESP plan provide a more than ample opportunity for Idaho Power executives to have a secure retirement. The incentive payments will be discussed in more detail in Staff witness Holm's testimony.

ADJUSTMENTS TO PENSION EXPENSE

Q. Please describe the Company's treatment of pension expense in its current rate filing.

A. Idaho Power's pension expense included in its rate filing is $7,018,000. However, Idaho Power proposed an adjustment of $2,170,160 increasing the pension expense from Net Periodic Pension Cost (Net Cost or FAS 87 Cost) to the Service Cost, less the amount capitalized as shown in Company witness Smith's Exhibit No. 19, page 4 of 6, line 5.

Q. Does Staff agree with this adjustment?

A. No. Idaho Power accrued the Net Periodic Pension Expense on its books as required by Statement of Financial Accounting Standards No. 87 (FAS 87) entitled "Employers' Accounting for Pensions." The Accounting Standards Board (Board) issued FAS 87 in an attempt to alleviate long-standing controversy regarding how to report for pension liability. As stated in FAS 87, page

2, the Board's objectives were as follows:

1. To provide a measure of net periodic pension cost that is more representationally faithful than those used in past practice because it reflects the terms of the underlying plan and because it better approximates the recognition of the cost of an employee's pension over that employee's service period.
2. To provide a measure of net periodic pension cost that is more understandable and comparable and is, therefore, more useful than those used in the past.
3. To provide disclosures that will allow users to understand better the extent and effect of an employer's undertaking to provide employee pensions and related financial arrangements.
4. To Improve reporting of financial position.

Q. Please explain the Service Cost.

A. The Service Cost is a calculation of the incremental increase in future benefit obligations due to an added year of service for each participant. It is only a calculation and not a cost to Idaho Power.

Q. What is Idaho Power's rationale for using Service Cost rather than Net Periodic Pension Cost?

A. The Company believes that Service Cost is more indicative of future pension costs going forward as stated in Company witness Smith's direct testimony, page 19, lines 7-9. Company witness Gale's direct testimony, pages 9 and 10, further states that using the Service Cost removes market volatility and the interest rate volatility, while quantifying the cost of an additional year of benefits to employees.

Q. Do you agree with their assertion?

A. I strongly disagree with the assumption that the Service Cost calculation is more representative of future costs going forward. Exhibit No. 108, page 1 of 5 is a simple line graph that illustrates the 10-year history of Service Cost, Net Periodic Cost and actual cash contributions funded to the pension plan. As you can see, the Net Pension Costs were actually closer to the amounts funded by Idaho Power over the past 10 years.

Q. What about Mr. Gale's statement that Service Cost removes the market volatility?

A. It is true that the Service Cost calculation is exclusive of any market volatility and interest rate volatility. However, I disagree that Service Cost should be used for ratemaking purposes. As stated in FAS 87, the net cost feature implies that the recognized consequences of events and transactions affecting a pension plan are reported as a single net amount in the employer's financial statements. This net cost approach aggregates at least three items that might be reported separately for any other part of an employer's operations: the compensation cost of benefits promised, the interest cost resulting from deferred payment of those benefits, and the results of investing.

The Accounting Standards Board recognized the importance of considering interest rates and investment returns when they mandated the use of Net Periodic Pension Cost for financial reporting purposes. The major component of retirement planning is investment return. Simply setting aside money that does not earn an investment return would defeat the purpose of investing, and would make pension plans prohibitively costly. Because the entire investment community expects that the market will produce positive rates of return in the long run, it would be inappropriate to exclude this major component of retirement when considering rates, as Service Cost does. Idaho Power's choice to use Service Cost for its filing produces a greater revenue requirement than Net Periodic Pension Cost. Idaho Power's methodology of using the Service Cost calculation would increase the revenue requirement without a legitimate offsetting increase in actual cost, resulting in a greater revenue requirement than necessary. Therefore Staff takes exception to the Idaho Power's adjustment to increase pension expense by $2,170,160 and recommends an equivalent adjustment to reduce the expense.

Q. Is the revenue requirement using the Service Cost always greater than the revenue requirement using the Net Periodic Pension Cost?

A. Not always, but in the case of Idaho Power Company, it will be for quite some time. It would require several years of negative returns for the revenue requirement associated with the Net Periodic Pension Cost to increase to the level of revenue requirement associated with the Service Cost. Even after the poor market performance of 2000, 2001 and 2002, the Net Periodic Pension Cost was still over $3 million less than the Service Cost. Considering the stellar market performance of 2003, the revenue requirement gap between Service Cost and Net Cost will be even greater going forward. By using the Net Cost methodology, Idaho Power would still be able to meet its pension obligations, but at a significantly reduced cost than it is requesting.

Q. Please describe Staff's next adjustment to pension expense.

A. Staff also recommends an adjustment that reduces test year pension expense by an additional $1,379,148.

Q. What is the basis for this additional adjustment?

A. During a review of the pension plan, it was determined that some of the actuarial assumptions for calculating the pension cost for the 2003 test year were changed from prior years. The discount rate was reduced from 7.00% to 6.75% and the future expected return on plan assets was reduced from 9.00% to 8.50%. Both of these changes generated an increase in Idaho Power's pension expense for 2003. Page 2 of Exhibit No. 108, which I will explain in detail later, will help illustrate Staff's argument.

Q. Is changing actuarial assumptions common?

A. Changes are not uncommon. However, the important requirement in determining actuarial assumptions is that they must be reasonable. When Idaho Power files the annual return (Form 5500 and attachments) for the pension plan with the Department of Labor, an actuary will sign the Schedule B verifying the calculations are reasonable. Though Idaho Power's changes in assumptions are reasonable, it has been my experience that actuarial assumptions will rarely change barring some major event.

Q. If the Company's actuarial assumptions are reasonable, then why is Staff concerned with these changes?

A. There are three reasons Staff is concerned with the changes in actuarial assumptions. First, as I mentioned earlier, the fact that these changes served to increase pension expense during the test year seemed a little suspect. Second, Staff reviewed the investment policy for the pension plan and there were no changes to that policy. If the reduction in expected return on assets was due to a change in investment strategies, the policy would have been updated to reflect that. In this case, there have been no recent changes to the investment policy. Lastly, when reviewing the workpapers of the Company's external auditors, Deloitte & Touche, LLP, Staff reviewed a letter from the Company's Technical Research Coordinator, Mark Annis, to the Company's actuaries, Milliman USA. This letter instructed the actuaries to use specific actuarial assumptions when preparing the pension plan computations.

Q. Is it unusual for Companies to choose their own actuarial assumptions?

A. It is uncommon, but it happens occasionally. Some actuarial firms have their clients agree to the actuarial assumptions as a method to reduce possible liabilities if those assumptions do not hold true. Staff believes that in determining their own actuarial assumptions, Idaho Power has the ability to game test year expenses to their advantage by increasing revenue requirement. Had it been Idaho Power's actuaries at Milliman USA who determined it necessary to change the actuarial assumptions based on extraordinary circumstances, Staff believes the changes may have been justified. Staff does not believe there have been any events to warrant these changes.

Q. Is it possible that economic factors, such as a bear market, would cause Idaho Power to reduce their expected rate of return on plan assets?

A. Current market performance should play only a minor role, if at all, in determining expected rates of future returns. To change the rate solely because of a few bad years would have been a premature, knee-jerk reaction. Retirement investing, by definition, is a long-term endeavor that requires consideration of long-term averages when comparing expected rates of return on investments. Historically, the market has always returned to averages. The recession in the early nineties was followed by unusually high returns in the mid to late nineties. While the market declined during 2000-2002, it reversed itself in 2003 and experienced huge gains. It is a yo-yo effect, but the stock market has always returned to its averages.

Q. Would you please describe Exhibit No. 108, page 2?

A. Exhibit No. 108, page 2 is a line graph that illustrates the historical rates of return of the Idaho Power Company Retirement Plan over the last 15 years. This confirms that the investments in the pension plan conform to historical market tendencies. The straight line through the middle of the graph is the average annual return for the same 15-year period (12.97%). The 2003 returns are calculated through November 30 and for simplicity, all contributions and distributions are weighted at 50% as if they occurred on June 30 rather than sporadically throughout the year. This chart supports Staff's assertion that markets trend to their averages, supporting Staff's recommendation to reduce pension expense by $1,379,149 to offset the increase due to Idaho Power's changes in the projected long-term rate of return on assets.

Q. How was this amount derived?

A. This amount was calculated using the Company's expected rate of return on assets of 9.0% that the Company used for several years prior to 2003, and keeping all other actuarial assumptions unchanged. See Exhibit No. 108, page 3 for the calculation.

Q. Please explain Staff's third adjustment to pension expense.

A. Staff also recommends reducing pension expense by an additional $5,638,851. This adjustment would reduce the pension expense to $0.00.

Q. What is the basis for this adjustment?

A. This adjustment is a reconciliation between cash and accrual accounting. As required by FAS 87, Idaho Power has accrued a pension contribution on its books for financial reporting purposes, but Idaho Power did not contribute to the plan for 2003 and therefore did not incur any actual costs. When dealing with pension plans, the FAS 87 accrued contribution amount and the amount that is actually contributed to the plan are completely unrelated. To determine the amount that Idaho Power is required to actually contribute to the pension plan, a different calculation is used entirely. Referring back to Exhibit No. 108, page 1, one can again see the significant difference between Net Cost per FAS 87 Cost and the amounts Idaho Power has contributed to the pension plan since the last rate case (Case No. IPC-E-94-5). Idaho Power does not actually contribute the amount identified for reporting purposes.

Q. Please describe how the actual cash contribution is calculated.

A. Under normal circumstances, companies have some discretion as to how much they contribute to a pension plan for a given year. There is a cost range and companies can contribute any amount between the Required Minimum Contribution and the Maximum Deductible Contribution. Section 412 of the Internal Revenue Code mandates the minimum funding, while section 404 mandates the maximum funding.

Q. Could you briefly explain how that cost range is determined?

A. The first calculation determines the Normal Cost for the year. The Normal Cost is the annual cost of the pension plan using the plan's actuarial cost method, as established in the plan document. The Normal Cost is a calculation that takes into consideration the present value of future benefits, the actuarial value of the plan's assets, any unfunded liabilities and the present value of the Company's future payroll. With that information, one can then calculate an accrual rate that when multiplied by the Company's current covered payroll will produce the Normal Cost. After the Normal Cost is calculated, any charges or credits are added or subtracted to get the Annual Cost. The Minimum Required Contribution is the lesser of the Annual Cost or the difference between the Full Funding Limitation and any credit balance. The Minimum Required Contribution is the amount that a company must fund in order to avoid a funding deficiency in the Funding Standards Account.

Q. You mentioned the term "Full Funding Limitation." Could you please describe this limitation?

A. The Full Funding Limitation is a calculation that compares the Actuarial Accrued Liability as calculated under the Employee Retirement Income Security Act (ERISA) of 1974, the Current Liability under the Omnibus Budget Reconciliation Act (OBRA) of 1987, and the Current Liability under the Retirement Protection Act (RPA) of 1994.

Q. Now that the minimum point in the cost range is established, how is the maximum point determined?

A. The Maximum Deductible Contribution is an IRS calculation that determines deductibility under Section 404(a)(1)(A) of the Internal Revenue Code. This calculation is based on a comparison of any unfunded liabilities and the Full Funding Limitation. A company may choose to contribute to a pension plan any amount that is greater than the Minimum Required Contribution but less than the Maximum Deductible Contribution.

Q. Based on these principles, what was the cost range for Idaho Power for 2003?

A. There was no range for Idaho Power for 2003. The Minimum Required Contribution was $0.00 and the Maximum Deductible Contribution was also $0.00.

Q. Does that mean Idaho Power did not contribute to the plan for 2003?

A. They did not. In fact, even if they wanted to, they could not have legally contributed to the pension plan without incurring penalties. They have not been able to contribute to the pension plan since 1995. Meanwhile, they continued to recover in rates more than $3 million per year from ratepayers for pension expense. Exhibit No. 108, page 4 illustrates the historical contributions since the last rate case versus the amounts that Idaho Power has recovered through rates for pension expense since the IPC-E-94-5 rate case. In aggregate, Idaho Power has recovered nearly $19 million more than they actually contributed to the pension plan since 1993.

Q. How can a company go for so long without making a single contribution to the plan?

A. A company can generate a prepaid pension expense for a variety of reasons. The most obvious reason is that companies use actuarial assumptions that are inaccurate. For example, prior to 2003 Idaho Power had assumed a future rate of return on assets of 9 percent. However, the average rate of return on pension plan assets for the past 15 years was 12.97 percent. When the pension plan's investment performance over time is that much greater than the projected rate of return, it creates a prepaid pension expense. It also discredits a change to reduce the expected future rate of return for funding calculations. Exhibit No. 108, page 5 illustrates the increase in prepaid pension expense since 1994. At the end of 2002, the Plan had a prepaid pension expense of nearly $28 million. Compounded with the stellar market performance for 2003, Idaho Power is not expected to have to contribute to the pension plan for several years. The Commission Staff believes it is highly inappropriate for Idaho Power to seek recovery of nearly $10,000,000 per year for pension expense when they have not had to contribute a single dollar to the pension plan for eight years and is unlikely to contribute to the plan for several more years to come.

ADJUSTMENTS TO PREPAID PENSION EXPENSE IN RATE BASE

Q. What is Idaho Power's treatment of prepaid pension expense in this current rate case?

A. Idaho Power proposes to include prepaid pension expense in rate base. The Company claims that because prepaid pension expense is reported as an asset on the Company's balance sheet, they should include it in rate base to earn a return on that investment. As explained in Audit Response No. 113, Idaho Power also argues:

> Including a prepaid pension amount in the rate base recognizes the investment and carrying costs the Company has incurred over the years, both in cash contributions and the value added through proper oversight, portfolio management techniques and asset allocation policies.

Q. Does the Commission Staff agree with Idaho Power's arguments?

A. No, the Staff disagrees with both arguments. Statement of Financial Accounting Standards No. 87 requires Idaho Power to report a prepaid pension expense as an asset for financial reporting purposes. However, prepaid pension expense is not an asset of the Company, but rather an asset of the trust that maintains the assets of the pension plan. Assets of a qualified retirement plan are required to be maintained in a trust. This trust acts as its own entity, separate from Idaho Power, and is assigned its own employer identification number by the IRS for financial reporting of the trust and withholding income taxes on plan distributions. Once money is deposited into the trust, there are a very limited number of circumstances in which the Company is allowed to use those assets for its own corporate use. Beyond those rare instances, a reversion of plan assets from the trust back to the Company is a violation of the Exclusive Benefit Rule and the Anti-Assignment and Alienation Rule of Employee Retirement Income Securities Act (ERISA). Even if the pension plan were to terminate, the amount of assets greater than the amount of liabilities cannot revert back to the Company without major penalties. In short, the asset that appears on the books is a result of payroll benefits. It is not an asset that provides electric service on which shareholders are entitled to earn a return.

Q. What are ERISA's Exclusive Benefit Rule and the Anti-Assignment and Alienation Rule?

A. The Exclusive Benefit Rule is one of the main premises that all qualified retirement plans are based on. It basically states that the assets of a qualified retirement plan must be for the exclusive benefit of its participants and beneficiaries.

The Anti-Assignment and Alienation Rule essentially states that a person's benefit in a qualified plan cannot be assigned to anyone else, except under a qualified domestic relations order in which the benefits are transferred to a former spouse. Benefits cannot be used as collateral for credit, nor can they be surrendered due to bankruptcy. A violation of either of these rules is serious enough to disqualify the Plan.

These rules prevent Idaho Power from having a reversionary interest in the pension plan's assets. Although the prepaid asset appears on a balance sheet, it should not be considered an asset included in rate base to earn a return for ratemaking purposes. It is clearly not an asset that should earn a return if Idaho Power has no ownership of the funds, no discretion on how those funds can be used, and those funds cannot be returned to them.

Q. What is Staff's position on Idaho Power's other argument that the inclusion of prepaid pension expense in rate base recognizes the carrying costs the Company has incurred over the years, both in cash contributions and the value added through proper oversight, portfolio management techniques and asset allocation principles?

A. Staff also disagrees with this argument. Idaho Power has not made any cash contributions to the pension plan since 1995, and any contributions prior to that were funded by customers. Also, any expenses generated by the pension plan have been paid from the Plan's assets. Since Idaho Power has not made any contributions to the pension plan and Idaho Power does not incur costs to maintain the plan, Staff disagrees that Idaho Power has incurred any "carrying costs".

Staff also takes exception to the argument that Idaho Power should be recognized for its proper oversight, portfolio management techniques and asset allocation policies. Those actions are fiduciary responsibilities required by ERISA, and Staff believes that Idaho Power should not be rewarded for performing actions that are required by law. Staff also believes that the performance of Idaho Power's retirement plan faired no better than the overall performance of the market in general. Exhibit No. 109 illustrates the comparison of the 15-year average annual rates of return of Idaho Power's pension plan versus the average annual rates of return for the Dow Jones Industrial Average (DJIA), the S&P 500 Composite Stock Index and the NASDAQ Composite Index over the same time period. The DJIA, S&P 500 and the NASDAQ averaged annual rates of return of 13.89%, 15.02% and 21.6% respectively since 1989. The fact that Idaho Power's pension plan averaged an annual rate of return of only 12.97% during the same period does not particularly support Idaho Power's argument that they should be rewarded for value added and proper management of the account. Therefore, Staff has removed the $17,800,477 in Prepaid Pension from rate base.

Q. Does that conclude Staff's pension-related adjustments?

A. Yes, that concludes Staff's pension-related adjustments.

ADJUSTMENTS TO OPERATING AND MAINTENANCE EXPENSES

Q. Would you please describe Exhibit No. 110?

A. Exhibit No. 110 is a list of Staff's adjustments to Operating and Maintenance (O&M) Expenses totaling $322,177. Staff believes it is inappropriate to pass on membership and association dues to customers if those associations do not provide products or services that, either directly or indirectly, allow Idaho Power to provide electricity to its customers. These expenditures may benefit other IDACORP affiliates, enhance the Idaho Power and IDACORP image, or provide a social presence for Idaho Power, IDACORP and its individually participating employees. Although this may be important for non-regulated operations, customers should not be forced to support an organization whose ideology they may not agree with by including these expenditures in customers' electric rates. Furthermore, in Case No. WWP-E-98-11 and subsequent Commission Order No. 28097, Staff argued and the Commission agreed that a percentage of Account 930 be removed from test year expenses because it included below-the-line expenses such as lobbying, enhancing the image of the Company in the community and efforts to maximize shareholder value.

Q. Please explain Exhibit No. 110, line 1.

A. Exhibit No. 110, line 1 is an adjustment that eliminates $246,048 from the test year for a portion of the dues paid to the Edison Electric Institute (EEI) by Idaho Power. Edison Electric Institute is an organization whose primary efforts are directed toward legislative lobbying and regulatory advocacy for shareholder-owned electrical utilities. According to The Center for Responsive Politics, a non-partisan, nonprofit research group that tracks money in politics and its effect on elections and public policy, EEI spent more on lobbying than any other organization in the Electric Utilities category. In fact, EEI spent as much on lobbying as the next four largest utility lobbying organizations combined. The lobbying expenditures of EEI were large enough to rank sixth overall amongst all industries nationwide. Idaho Power has an internal position, Vice President of Public Affairs, whose sole responsibility is representing the Company on major political issues. The efforts of EEI and this position essentially overlap and are duplicative.

Staff has consistently viewed EEI as an organization whose activities are primarily for the benefit of shareholders. EEI's research information is disseminated through other sources available to Idaho Power and its receipt is not dependent upon membership. EEI activities also benefit IDACORP and its affiliates. Though Staff believes all dues paid to EEI should be removed from the test year, we have only removed 75% of the dues to remain consistent with precedent set in Commission Order No. 25880, Case No. IPC-E-94-05.

Q. Please continue with your explanation of Exhibit No. 110.

A. Exhibit No. 110, line 2 removes $3,967 from the test year membership dues and contributions paid to various Rotary Clubs. Line 3 removes $1,689 from the test year various contributions made to local Kiwanis Clubs. Line 4 removes $717 from the test year in contributions made to various Lion's Clubs. These organizations are social or spiritual organizations that provide no benefit related to the provision of electricity for Idaho Power customers. Though Staff commends Idaho Power contributing to these fine organizations, it is inappropriate to charge those expenses to ratepayers. Any customer desiring to belong to or contribute to these or other organizations may voluntarily do so on their own. Customers should not be required to pay for these costs in electricity rates.

Q. Would you please explain line 5 on Exhibit No. 110?

A. Line 5 is the adjustment that removes $24,490 from test year expenses that Idaho Power paid to the Chambers of Commerce of several Idaho cities. Chambers of Commerce are advocates for businesses on issues that impact the ability of regional businesses to be successful in a competitive marketplace. Because Idaho Power is a monopolistic utility, the Chambers' actions do not have an impact on Idaho Power's ability to be successful. Staff has removed these expenses, similar to dues and contributions, because they benefit IDACORP affiliates, non-regulated operations and shareholders, but not ratepayers.

Q. Would you please describe line 6 of Exhibit No. 110?

A. Line 6 is the adjustment to remove $2,000 from test year expenses that Idaho Power contributed to the Democratic National Party and the Republican National Party. It is not appropriate to use money received from customers to support political organizations that the customers may have serious disagreements with. Therefore, Staff has adjusted the O&M Expenses to exclude these contributions.

Q. Would you please explain line 7 of Exhibit No. 110?

A. Line 7 is Staff's adjustment to remove from test year expenses $7,200 for memberships to the exclusive Arid Club for the following Idaho Power officers: President and Chief Executive Officer, Jan Packwood; President and Chief Operating Officer, Lamont Keen; Vice President, Chief Financial Officer and Treasurer, Darrell Anderson; and Senior Vice President of Delivery, James Miller. Staff believes there may be other officers and employees whose membership dues are paid for by Idaho Power, but we were unable to identify them specifically. Staff opines that customers receive no benefits from these exclusive memberships and these expenses should not be charged to customers.

Q. Would you please explain line 8 of Exhibit No. 110?

A. Line 8 is the aggregate sum of all items listed on page 2 of Exhibit No 110. These are items that are too small and numerous to discuss individually at length, but include contributions to the American Lung Association, Historic Downtown Association, educational entities and others. Staff sees no benefits provided to customers from these expenses and believes these expenses should not be charged to ratepayers. The total of all these expenses is $36,066 as shown in line 8.

ADJUSTMENT TO MANAGEMENT EXPENSES

Q. Please explain Exhibit No. 111 entitled "Adjustments to Management Expenses"?

A. During Staff's audit of Idaho Power, we requested to review the expense reports of all management personnel. Due to time constraints, we chose six managers and fully scrutinized their expenses. We then perused the remaining reports to identify any obvious expenses to which Staff might disagree.

The review consisted of two steps: First, we determined if any of the expenses were not reasonable and should therefore be removed from the test year. Second, Staff presumed much of these expenses were associated with non-regulated operations or affiliate operations and that a portion of these expenses should be allocated to IDACORP or below the line. In order to determine the proper allocation, we extrapolated the allocations from these managers' salaries that were paid by IDACORP, its other affiliates or below the line. Exhibit No. 110 summarizes the scrutinized expenses of the six managers. We totaled all of the expenses for each manager, subtracted the expenses we believe to be inappropriately charged to customers, and then multiplied the remaining expenses by the allocation factor determined from the payroll allocation.

The majority of the expenses removed were for travel and expenses for EEI conferences. Using the rationale explained earlier, we have removed 75% of these expenses. Other expenses Staff removed were meetings with Oregon politicians and lobbyists, Washington D.C. lobbying expenses and excessive meal expenses. We also removed expenses for green fees at golf courses, liquor store purchases, wine purchases and other entertainment purchases. These expenses are not an ordinary or necessary cost of doing business, are excessive and are unreasonable to charge to customers.

ADJUSTMENTS TO LEGAL EXPENSES

Q. Would you please explain the adjustment to legal expenses that you mentioned earlier in your testimony?

A. This adjustment relates to expenses paid for outside legal advice for Idaho Power's and IDACORP Energy's (IE) defense in the California Refund Case and the Pacific Northwest Refund Case. In June 2001 the Federal Energy Regulatory Commission (FERC) established price mitigation for sales in the wholesale electricity market. Several wholesale purchasers alleged that energy traders participated in price manipulation of spot market prices. If the FERC or an appeals court determines that those prices were unjust and unreasonable, the trading entities may be ordered to refund a portion of their spot market sales prices.

These alleged improprieties were performed by IE and not Idaho Power. Idaho Power was named as a defendant in the cases because IE utilized Idaho Power's trading license until IE obtained a separate license for itself. Staff believes that IE or IDACORP should be held fully responsible for the costs associated with these cases. Customers should not bear the burden of IE's defense because IE's trading activities were non-operating, and customers did not benefit from IE's transactions.

One reason IDACORP was established was to shield Idaho Power from liability for non-operating and non-regulated affiliate activities. Idaho Power argued in Case No. IPC-E-97-11 and the Commission agreed in Order No. 27348 that transferring Idaho Power's non-utility subsidiaries and operations to a holding company would reduce the risk for the utility's operations. Thus, the purpose of creating a holding company was to allow subsidiaries to engage in speculative ventures without creating risks for Idaho Power and ratepayers. To later have Idaho Power financially responsible for legal expenses resulting from IE's actions entirely defeats the purpose of creating the holding company. Therefore, we have removed $352,544 from the test year for legal expenses that should not be paid by customers. These expenses should be allocated directly to IE or IDACORP.

INTEREST ADJUSTMENTS

Q. Did you review Idaho Power's known and measurable adjustment to American Falls interest?

A. Yes. Idaho Power proposed a known and measurable adjustment to increase interest expense for 2004 for the interest on American Falls Bonds. At the time Idaho Power filed their case, only the interest amounts for the first six months of 2003 were known. Idaho Power forecasted the interest rate on the American Falls Bonds through the end of 2003 and all of 2004.

For 2003, Idaho Power calculated interest rates from July 22, 2003 through December 31, 2003 using a trend line developed by a regression equation using actual data from January 1, 2003 through July 22, 2003. This trend line is shown in a line graph prepared by Idaho Power that is included as Staff Exhibit No. 112, page 1. Staff reviewed the analysis and determined the 2003 forecast to be reasonable. Any differences between actual amounts and budgeted amounts are captured in the budget-to-actual adjustments presented by Staff witness Holm.

For 2004, Idaho Power used a completely different methodology to calculate the interest on these bonds. Exhibit No. 112, page 2 illustrates Idaho Power's forecasts for the interest rates through the end of 2003 and all of 2004. Page 2 of this Exhibit is similar to page 1 except that it includes Idaho Power's 2004 interest rate forecast on the same graph. Idaho Power forecasted an interest rate of 2.3% on December 31, 2003 and 4.2% on January 1, 2004. Using Idaho Power's methodology, an increase in interest rates of nearly 2% occurs overnight. This large differential is not reasonable given that interest rates deviated approximately 0.5% over the past year.

Q. How does Staff propose to treat the interest for these bonds?

A. The Company's adjustment was based on the premise that the increase in interest was known and measurable. Staff believes that the increase is neither known nor measurable. Staff believes the methodology used by Idaho Power grossly overstates the forecasted interest rate. Therefore Staff cannot accept Idaho Power's adjustment and proposes an adjustment of $297,436 to the Company's filing to remove the additional interest expense included in operating costs for falling water payments.

If the Commission were to allow an adjustment, Staff recommends using the most recent interest rate available, 2.35% as of January 20, 2004. All things remaining constant, the best indicator of a future interest rate is the current rate. Using this current rate, Staff would propose an additional adjustment of $29,418.50, thus decreasing the test year interest expense to an amount more likely to be expensed for 2004.

Q. Is this Staff's only adjustment to interest rates?

A. No. Staff also reviewed the interest rates of the four variable interest Pollution Control Revenue Bonds. For these bonds, Idaho Power used an estimated interest rate based on the 10-year average of the Bond Market Association (BMA) Index, plus the average spread over the BMA Index on the life of the bond. Staff disagrees with this methodology. Exhibit No. 112, page 3 is a table comparing Idaho Power's forecasted interest rates on these Pollution Control Revenue Bonds to the actual interest rates as of December 31, 2003. Also, as shown in Exhibit No. 112, page 1, interest rates have been trending downward and remain at all-time lows. It would be inappropriate to use a methodology that unfairly skews the interest rates higher and inflates the effective embedded cost of long-term debt. Customer electricity rates should reflect debt capital costs that most accurately reflect the actual cost of the debt. For fixed rate debt, this rate is the embedded effective cost rate. For variable debt, this rate is the current rate or a known and measurable projected rate. Staff cannot support the jump from 2003 actual variable debt rates to the forecasted variable rate. The 10-year average is not reflective of the current rate or the rates for the last several years. Therefore Staff does not accept the 10-year average methodology as the best indicator of the variable debt rate.

Company witness Gribble testified that Idaho Power's capital structure in its filing is based on estimated year-end 2003 financial results. Furthermore, Mr. Gribble testified that the Commission could update the capital structure in this proceeding to incorporate actual year-end 2003 financial results. Staff witness Carlock uses the updated capital structure in support of her testimony. If the capital structure is updated, it would be appropriate to also update the interest rates on capital debt to actual levels. Therefore, Staff recommends using the current interest rate as of December 31, 2003 to determine the actual 2003 year-end cost of debt. This adjustment reduces the long-term interest expense by $3,083,000. Staff witness Carlock will discuss these adjustments in more detail.

Q. Does this conclude your direct testimony in this proceeding?

A. Yes, it does.