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April 15, 2011

VIA HAND DELIVERY

Jean D. Jewell, Secretary
Idaho Public Utilities Commission
472 West Washington Street
P.O. Box 83720
Boise, Idaho 83720-0074

Re: Case No. IPC-E-10-25
IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR ACCEPTANCE OF ITS 2011 RETIREMENT BENEFITS PACKAGE

Dear Ms. Jewell:

Enclosed for filing please find an original and seven (7) copies of Idaho Power Company's Second Reply Comments in the above matter.

Very truly yours,

Lisa D. Nordstrom

Lisa D. Nordstrom

LDN:csb
Enclosures

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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF IDAHO POWER COMPANY FOR ACCEPTANCE OF ITS 2011 RETIREMENT BENEFITS PACKAGE.	CASE NO. IPC-E-10-25 IDAHO POWER COMPANY'S SECOND REPLY COMMENTS

COMES NOW, Idaho Power Company ("Idaho Power" or "Company"), and in response to comments of the Idaho Public Utilities Commission Staff ("Staff") and the Industrial Customers of Idaho Power ("ICIP") filed in this docket on April 8, 2011, submits the following Second Reply Comments.

I. IDAHO POWER'S SUPPLEMENTAL REPORT COMPLIES WITH THE IDAHO PUBLIC UTILITIES COMMISSION'S ("COMMISSION") DIRECTIVE AND APPLIES REASONABLE ASSUMPTIONS

The Company is in agreement with the Commission Staff that it has complied with Commission Order No. 31091, as well as the Commission's January 24, 2011, directive to provide additional information regarding its 2011 Retirement Benefits Package. Second Staff Comments at 5. The Company's *Supplemental Report:*

Retirement Benefits Risk Analysis ("Supplemental Report") filed on February 18, 2011, included an analysis of the potential investment risk associated with various investment strategies. This type of analysis is difficult because it requires making assumptions – a lot of them. Mr. Randy Lobb's statement at the January 24, 2011, workshop effectively summarized what should be expected from such an analysis: "In projecting the future, you have a wide range of assumptions that you could make and a wide range of outcomes." Workshop Tr. at 52. Both Staff and Idaho Power agree that forecasting investment and employee benefit scenarios would likely be "a little inconclusive" and is unlikely to give "a definitive answer on what the best plan is and what the least costly plan or what the greatest risks are for any particular plan going forward." *Id.* at 50-53. Rather, "it's going to give you more information about market conditions and certainly what types of programs shift risk to what sort of parties." *Id.* at 52.

Not knowing the future with any certainty, Idaho Power *and* its actuaries made a number of educated assumptions to complete the analysis found in its Supplemental Report. The Commission Staff questioned several of the assumptions but did not offer any alternatives in its Second Comments filed on April 8, 2011.

A. Investment Rate-of-Return Assumptions. To determine the range of economic conditions in its analysis, the Company used a historical period of 1972 to 2009 to simulate the various possible investment returns under various economic conditions, including both good and bad investment markets. The Company then adjusted the returns downward to account for current interest rates. Staff believes it is not necessary to adjust long-term potential returns downward based on current interest rates because "a 37-year period should be sufficient to show a variety of potential market returns, and future adjustment reduces the integrity of the assumptions and their results." Second Staff Comments at 3.

With regard to the Company's investment return assumptions used in its Supplemental Report, it is important to note that higher assumed interest rates translate into higher overall returns, resulting in lower future funding obligations for the pension plan. Therefore, because the hypothetical defined contribution plans analyzed by the Company had fixed returns of 8 percent (modeled at the request of Staff and ICIP) and 7 percent, the Company's defined benefit plan would be even more attractive with higher investment return assumptions. With that said, the Company views its interest rate adjustment as conservative and quite reasonable when current interest rate levels are compared to historical interest rates.

According to Ibbotson Associates, a leading authority on asset allocation with expertise in capital market expectations, the rate of return on intermediate-term government bonds from 1972 through 2009 was 7.8 percent. If the Company did not make an adjustment for the current interest rate environment, an asset allocation of 100 percent bonds would be expected to generate (on average) a 7.8 percent return going forward, which would nearly satisfy the Company's actuarial return assumption of 8 percent. That is not realistic because the current yield on the 10-year U.S. Treasury Bond is 3.6 percent, or less than one-half of the 7.8 percent historical number.[1] The Company's projections include an improvement from current levels to a projected bond return in excess of 5 percent; however, a 7.8 percent projected return on the fixed-income portion of the portfolio from the current starting point is just not reasonable.

[1] *Ibbotson SBBI 2010 Classic Yearbook*, Table C-5, *Intermediate-Term Government Bonds: Total Returns*, p. 258.

Further, the Company's assumed total rate-of-return is already on the high end of the range of assumptions utilized by similar plans, and using an even higher expected rate-of-return would likely draw scrutiny from the Company's auditors, actuaries, and possibly federal agencies such as the Pension Benefit Guaranty Corporation, Department of Labor, and Internal Revenue Service.

B. Employee Count. In its Supplemental Report, Idaho Power projected a 3 percent annual growth in eligible employee count, which results in a total eligible employee count of 2,619 in year 2019 as compared to 2,007 eligible employees in 2010. Staff indicated that it believes it is "unlikely the Company will need to add an additional 612 employees by 2019." Second Staff Comments at 4.

The Company's projected 3 percent annual growth in eligible employee count is reflective of the Company's actual historical eligible employee growth rate. The Company has no reason to believe that it will experience a level of employee growth during the analysis period different from the assumed level. However, if the actual level of employee growth is less than the assumed level, the financial impact that fewer employees would have on the Company's pension plan would be similar to that which would exist under a substitute defined contribution plan. That is, required future contributions associated with different levels of employee counts would change in similar proportions under each of the plan designs analyzed by the Company.

C. Wage Increase. Idaho Power's Supplemental Report also assumed an annual wage increase of 4.5 percent through 2019. Staff noted that annual utility wage increases are increasingly scrutinized by regulators in recent years and believes the Company's assumption is unreasonable. Second Staff Comments at 4.

The Company views the annual wage increase assumption of 4.5 percent to be reasonable based upon historical rates of inflation. According to Ibbotson Associates, the annualized rate of inflation from 1972 through 2009 (the same 37-year period used to represent potential market returns) was 4.5 percent.[2] It is true that inflation has been muted in recent years, but it also true that there is a growing concern in the financial community regarding the re-emergence of inflationary pressures. Further, it should be noted that this assumption represents individual participants' expected changes in salary due not just to inflation but also to promotions and merit salary increases for employees that are below market rates of pay.

Staff argues that although the assumptions were consistent for comparing the defined benefit and defined contribution plans, the assumptions may increase the projected cost of a defined contribution plan more than they would increase the projected costs of the defined benefits plan. *Id.* As described above in Subsections A through C, the Company views the assumptions challenged by the Staff as either being conservative in nature or as having similar impacts across each of the plan designs analyzed.

II. TIME PERIOD USED FOR COMPARISON PURPOSES

Both Staff and the ICIP were critical of the time period over which Idaho Power analyzed investment risk and plan costs. Staff does not believe the nine-year projection included in Idaho Power's Supplemental Report adequately assesses the risk associated with a pension plan, which is less costly initially because market volatility does not have the same impact on the asset balance of the plan in the early years. *Id.*

[2] *Ibbotson SBBI 2010 Classic Yearbook*, Table C-7, Inflation, p. 270.

The model that Milliman, Idaho Power's actuary, utilizes does not generate actuarial projections, including estimates of future contributions beyond ten years. Due to the uncertainty and limited value of projections longer than ten years, Milliman does not currently utilize models for longer time periods. The most recent formal actuarial valuation for Idaho Power's pension plan is 2010; therefore, the Company illustrated forward projections for the future nine-year period 2011 through 2020.

If a nationally recognized benefits valuation expert like Milliman believes it is inappropriate to place reliance on a model beyond ten years, Idaho Power is not in a position to suggest otherwise. Idaho Power understands the desire of Staff and the ICIP for a longer comparison period; however, the Company simply cannot rely on the accuracy of any further extrapolation of projections based on current conditions over a longer period of time.

III. COMPONENTS OF THE RETIREMENT BENEFIT PACKAGE

On pages 4 and 5 of the ICIP's Comments Regarding Idaho Power's Supplemental Report, ICIP presents its understanding of the roles of the defined benefit plan and 401(k) plan in the Company's retirement benefits package. Based on ICIP's comments, it is not clear to the Company that ICIP has a correct understanding of the relationship between the Company's 401(k) plan and the defined benefit plan.

The Company's retirement benefits package includes three components: (1) a defined contribution or 401(k) benefit plan, (2) a defined benefit pension plan, and (3) a retiree medical benefit plan. Eligible employees can participate in all three components of the retirement benefits package. In total, according to the Towers Watson analysis, the Company's retirement benefits package was shown to have a cost below market.

The Company's analysis in the Supplemental Report looked at replacing the defined benefit portion of the package with a defined contribution plan that would provide the same total level of benefits at retirement. If implemented, that change would increase the benefit level associated with the existing 401(k) plan from 4 percent of base pay to a level closer to 10 percent in order to replace the discontinued benefits from the defined benefit portion of the package. That is, the defined contribution alternatives analyzed would expand the benefits associated with the current 401(k) plan and eliminate the defined benefits plan.

It should also be noted that the original creation of the existing 4 percent defined contribution plan was the result of a previous risk mitigation effort relative to the defined benefit plan. Whereas the Company's defined benefit plan had routinely allowed post retirement inflation adjustments to beneficiaries, similar to the inflation adjustments in the Public Employees Retirement System of Idaho plan, a decision was made in 1994 to eliminate such adjustments. Employees were directed to utilize the defined contribution plan and contribute their own dollars in addition to the company match in order to provide for the impacts of inflation on their retirement income. It is important to realize that the existing 401(k) defined contribution plan is offered to supplement the elimination of a feature previously provided in the defined benefit plan.

The Company believes that the alternatives analyzed in the Supplemental Report are reasonable and support its proposal in this docket. Further, the plan alternatives analyzed in the Supplemental Report are consistent with those discussed and agreed upon by all parties, including ICIP, at the workshop held on February 10, 2011.

IV. EQUIVALENT BENEFITS BETWEEN PLAN ALTERNATIVES

The Company has set its 2011 Retirement Benefits Package at a competitive cost level that is less than the median offerings of similarly situated utility peers. In doing so, Idaho Power has carefully considered not only the allocation of costs and investment risks between customers and employees but also the operational imperative to maintain safe, reliable service with an engaged, qualified, experienced, and flexible workforce.

Yet ICIP states that "without a complete analysis of the Company's compensation levels compared to its competitors, it is unreasonable to assume that the Company's matching contribution must keep its employees in the same position as they would be under the defined benefit program." ICIP Comments Regarding Idaho Power's Supplemental Report at 6. As explained in its Application and testimony,[3] Idaho Power conducts a detailed review of its employee compensation annually to assess how the Company compares to its peers, industry generally, and the local economy. Exhibit No. 1 to Ms. Gerschultz' testimony shows that the costs Idaho Power incurs associated with retirement benefits is well below the energy services industry average, and it is also below the average for all industry across the country. In order to move below the national average for all industry, Idaho Power reduced the expenses associated with the defined benefit plan by 20 percent.

Moreover, the ICIP's statement contradicts its position at the January 24, 2011, workshop. At the workshop, Mr. Donn English presented the Staff's position with regard to the Company's request. Mr. English stated that "we didn't feel that the Company needed to necessarily reduce benefits." Mr. English went on to say, "[w]e felt the

[3] *See* Application at 5-6 and Gerschultz Direct Testimony at 5-6.

Company should just evaluate other options [and] that could provide the same level of benefits but reduce the volatility and rates." Workshop Tr. at 7. All parties represented at the workshop, including ICIP, generally agreed with the Staff's position that any option evaluated should provide the same level of benefits. ICIP's position was made explicitly clear when Mr. Greg Adams later stated "[w]ithout repeating a lot of what Mr. English said on behalf of Staff, I'll just say that we agree 100 percent with the Staff's position in this case." Workshop Tr. at 33.

V. ASSIGNMENT OF RISK

According to Staff, the Company's Supplemental Report "does not go far enough in addressing the potential risks customers face during a period of declining market returns, nor does it adequately address the assignment of risk between shareholders and employees." Second Staff Comments at 4.

The Company believes that when it seeks recovery of prudently incurred defined benefit plan costs in the future, the Commission should not ignore the benefits that customers received by assuming some investment risk. As explained in the Company's Reply Comments filed on December 28, 2010, the level of risk borne by customers has resulted in significant customer benefits through the return on assets contributed to the plan. These benefits were particularly evident during the years 2004 through 2010 in that no customer costs related to the defined benefit plan occurred until the spring of 2010. The growth in plan assets due to the assumption of market risk is precisely the reason that the Commission could provide no current recovery of pension costs from 2004 to the spring of 2010; however, the Company was still able to provide a competitive benefit to its employees.

Essentially (and expressed in nominal dollars), <u>the Company's customers have received more than $600 million in value from approximately $100 million of plan contributions</u> from 1976 through 2009. This performance would not have been possible without the assumption of some market risk. If the same dollars as were contributed to the trust fund had been invested at a risk free rate, the plan value would be markedly less. Had the Company sought to minimize or eliminate investment risk while at the same time providing the same level of benefits to employees in order to remain competitive, the cost to customers would have been significantly higher.

The ICIP's table on page 7 of its Comments and the Staff's discussion on page 4 of its Comments incorrectly suggest that the year-to-year changes in the value of plan assets over time is entirely due to market volatility. The value of plan assets over time is also significantly impacted by benefit payments and plan expenses. For example, in the ten years between 1998 and 2008, plan assets were reduced by approximately $149 million for benefit payments and plan expenses. The Staff and the ICIP ignore the benefits of the investment risk assumed by the plan while overstating the customer impact of volatility.

While the Staff and the ICIP refer to "assigning risk between shareholders and employees," that idea misinterprets the roles of shareholders and customers in funding retirement benefits. Shareholders provide capital to construct plant to serve customers in exchange for the opportunity to earn a return on their investment over time. Customers provide funding for reasonable utility operations and maintenance expenses, including labor expenses like retirement benefits, through rates. Because shareholders have no opportunity to earn a return on pension contributions, it would be improper to assign pension costs and risk to them. Under the present regulatory model, risk should be assigned between employees and customers.

VI. PUBLICLY AVAILABLE DATA

The ICIP submits that customers should be made aware how large the Company's estimated contributions to its pension fund will be in the next nine years, and how much customers will be asked to contribute. ICIP Comments Regarding Idaho Power's Supplemental Report at 8, n. 2. Idaho Power conducted a review and analysis of the extent of publicly available information and materiality of the information in the Supplemental Report and disclosed publicly as much information as possible in this case without creating significant compliance concerns under Regulation FD promulgated by the Securities and Exchange Commission ("SEC") pursuant to the Securities Act of 1933, which addresses the selective disclosure of information by publicly traded companies. In addition to Regulation FD concerns, public release of the information in advance of its disclosure through SEC-authorized means also creates liability concerns under Section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder.

Following Idaho Power's submission of its February 18, 2011, Supplemental Report, on February 24, 2011, the Company filed with the SEC and posted to the Company's Internet website its annual report on Form 10-K for the year ended December 31, 2010,[4] containing detailed disclosure of certain aspects of its retirement benefit plans.[5] While it is nearly impossible to predict how much pension expense the Commission will allow Idaho Power to collect in rates over any future time period, the

[4] Idaho Power's 2010 Annual Report is available at: http://www.idacorpinc.com/financials/annlreps.cfm.

[5] See, in particular, Note 11 – "Benefit Plans" to the financial statements included in the 2010 Annual Report.

Company's estimated contributions to its pension fund through 2015, as well as other information relating to the Company's retirement benefit plans, are now publicly available in its 2010 Annual Report. *See* 2010 Annual Report at 47 and 121-130.

VII. CONCLUSION

In its Application and testimony, Idaho Power demonstrated that the costs of its 2011 Retirement Benefits Package were well below the comparable costs incurred by a peer group of companies and were also below the comparable costs for all industries. In the Supplemental Report, the Company demonstrated that its current targeted allocation of investments that support the pension portion of retirement benefits provides an opportunity to meet the actuarial target of 8 percent, while reasonably managing the range of volatility in average annual returns around the 8 percent target.

The Company, with its 2011 Retirement Benefits Package, reduced pension related retirement benefits for new employees by 20 percent. The expected average annual funding obligation for new employees over the next nine years is $1.2 million per year. The expected average annual funding obligation for new employees over the next nine years that would occur if the Company moved to a defined contribution plan would be $4.2 million per year based upon an actuarial expectation of a 7 percent annual return on investments. If a defined contribution plan could earn returns equal to a defined benefit plan, the expected average annual funding obligation could be $3.6 million per year, $2.4 million per year greater than expected under the Company's current plan.

The Company's investment portfolio associated with its defined benefit plan appropriately balances risk and returns at a lower cost than the modeled defined contribution plan alternatives. The analyses presented in the Supplemental Report demonstrate that the level of risk borne by Idaho Power's customers related to a defined benefit plan is reasonable and is likely to result in lower costs over time as compared to other alternatives.[6]

As evidenced by the information filed by the Company in this docket, Idaho Power believes that it has acted reasonably and prudently to develop a market competitive retirement benefits package that will meet the Company's operational and financial objectives and will serve in the best interests of its customers. Therefore, Idaho Power respectfully requests that the Commission issue its Order accepting the Company's 2011 Retirement Benefits Package as a reasonable approach to providing employee benefits.

DATED at Boise, Idaho, this 15th day of April 2011.

Lisa D. Nordstrom

LISA D. NORDSTROM
Attorney for Idaho Power Company

[6] Public Employee Retirement Systems of Idaho, Outline of DB/DC Study Findings, January 2011. (Finding that "DC Plans generally have a higher cost of investment fees and administrative fees" and "switching to a DC plan does not necessarily save the State money.")

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 15th day of April 2011 I served a true and correct copy of IDAHO POWER COMPANY'S SECOND REPLY COMMENTS upon the following named parties by the method indicated below, and addressed to the following:

Commission Staff Weldon B. Stutzman Deputy Attorney General Idaho Public Utilities Commission 472 West Washington P.O. Box 83720 Boise, Idaho 83720-0074	_X_ Hand Delivered ____U.S. Mail ____Overnight Mail ____FAX _X_ Email Weldon.Stutzman@puc.idaho.gov
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