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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** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Weldon B. Stutzman, Deputy Attorney General, and in response to the Notice of Application and Notice of Modified Procedure issued in Order No. 32092 on October 15, 2010, submits the following comments.

BACKGROUND

On October 1, 2010, Idaho Power Company filed an Application with the Commission requesting the Commission accept the Company's 2011 retirement benefits package. The Company does not request recovery of additional pension plan contributions in this Application.

Earlier this year the Company requested authorization to recover in customer rates its 2010 cash contributions to its defined benefits plan. The Commission approved the request in Order No. 31091, but directed the Company to review appropriate changes to its pension plan. Specifically, noting that Company pension payments may total nearly $157 million during

2014-2018, the Commission stated that "it is unreasonable for Idaho Power's customers to be solely responsible for large contributions to the Company's defined benefit pension plan." Order No. 31091, p. 3. The Commission directed the Company to "consider changes to its retirement plan and address shareholder and employee liabilities in assignment of pension plan investment risk." *Id.* Finally, the Commission stated that it "will not approve recovery of additional pension plan contributions from customers without evidence that Idaho Power has carefully reviewed alternatives to reduce the burden placed on customers." *Id.*

The Company's Application states that its filing "is intended to provide the Commission with evidence that the Company has evaluated the costs of its retirement benefits package, has considered and implemented changes, and has a prudent retirement benefits package with a reasonable cost burden for Idaho Power customers." Application, p. 2. 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. The 401(k) benefit plan and retiree medical benefits components place all market and inflationary risk on retirees. The Application states that the defined benefit portion of the package places market risk on the Company, although as explained later, this risk is passed on to customers. The Company removed inflationary risk by not including a cost of living adjustment feature in the defined benefit portion. Application, p. 4.

The Application states that the Company's board of directors voted to reduce the cost of the retirement benefits package for new employees hired after January 1, 2011, from approximately 9.1% of a new salaried employee's base pay to approximately 7.9%. As a result, the defined contribution 401(k) benefit portion will comprise approximately 38% of the new retirement benefit costs, and the defined benefit portion will comprise 59%. The remaining 3% will be associated with the retiree medical benefit plan. Application, p. 5. Because the changes to the retirement benefits package applies only to new employees, the cost savings from the modification will be minimal initially but will grow over time as a larger proportion of the Company's workforce is included in the new benefits calculation. The Company expects the changes to result in approximately $1.97 million annual savings once the Company's workforce is fully transitioned to the modified benefit plan. Application, p. 6.

STAFF REVIEW

Staff reviewed the Company's Application and the accompanying testimony of Gregory W. Said, Darrel Anderson, and Sharon Gershcultz, along with information obtained through production requests. Staff also reviewed previous Idaho Power cases dealing with pension accounting and pension contributions as well as Commission Orders in those cases. Based upon its review, Staff believes that Idaho Power Company failed to comply with the Commission's Order. Staff views the Company's evaluation as incomplete for the following reasons: (1) it results from flawed instruction from Mr. Anderson, (2) it began with a flawed premise, and (3) the evaluation did not adequately consider all available alternatives. Staff believes the Company's evaluation of its Retirement Benefits Package was affected by a predetermined end result that led the Company to exclude other viable retirement benefit options in its analysis. Based on this conclusion, Staff recommends that the Commission reject the Company's request for acceptance. If the Company's benefit plan review is accepted by the Commission, Staff believes it would be inappropriate for the Commission to pre-approve any costs associated with the 2011 Retirement Benefits Package for rate recovery in customer rates, as suggested by the Company.

In these comments, Staff summarizes the three plans included in the Idaho Power 2011 Retirement Benefits Package, addresses Staff's understanding of the Commission's directive in Order No. 31091, explains why Staff believes the Company's evaluation was incomplete and based on a flawed premise and directions, discusses the erroneous assumptions used in the Company's evaluation, and provides a sampling of other alternatives that the Company should include in future evaluations.

<u>Summary of Retirement Benefits Package</u>

The Retirement Benefits Package offered by Idaho Power consists of three parts: (1) a defined contribution or 401(k) benefit plan, (2) a defined benefit (pension) plan, and (3) a retiree medical benefit plan. The Company claims that the retirement benefit packages currently represents approximately 9.1% of a new salaried employee's base pay, and as modified, represents approximately 7.9%. These calculations and the assumptions used in the calculations could not be verified by Staff because they were completed by a third party consultant using a proprietary database. The Company contends that the information is confidential, as it did with much of the information requested by Staff in this case.

Defined Benefit Pension Plan

The Pension Plan of Idaho Power Company was established in 1943 and is available to regular, temporary, and part-time employees who are 18 years of age or older and have completed 12 consecutive months of employment. The defined pension benefit paid at retirement under the current plan is based on three main determinants: (1) the number of years of service credited for the employee, (2) the "Final Average Earnings" of the employee, and (3) the employee's age at retirement. As described in the Direct Testimony of Darrel Anderson, the Final Average Earnings is the average total earnings during the highest 60 consecutive months in the final 120 months of service with the Company. The pension payout formula applies a factor of 1.5 percent to the number of years of service to derive a benefit percentage. The benefit percentage is then multiplied by the Final Average Earnings to determine the final annual pension payout. Under the plan as modified, the 1.5 factor is reduced to 1.2. The plan has a minimum annual benefit level equal to $144 for each year of credited service. If this amount is greater than the annual benefit derived under the above formula, the employee will receive the greater amount. Employees must accumulate five years of service to be fully vested in the plan.

Employees are eligible to retire early at age 55, provided they have completed ten years of service. Normal Retirement Age under the plan is age 65, however employees can retire at age 62 without receiving a reduced benefit. Employees who retire prior to age 62 receive a reduced benefit based on their age at retirement.

The 401(k) Defined Contribution Plan

The Idaho Power Company Employee Savings Plan is a 401(k) plan established in 1979 where employees can contribute the lesser of 100% of the base salary and annual bonuses or the annual limitation under Internal Revenue Code §415(c), which was $49,000 in 2009 but is adjusted annually for cost-of-living. Employee Contributions can be classified as a 401(k) Deferral (pre-tax), a 401(k) Roth Contribution (after-tax), or a Savings Plan (after-tax). Employee Contributions are then matched by the Company at a rate of 100% of the first 2% of employee eligible pay contributed, and 50% of the next 4% of employee eligible pay contributed. Employees who contribute 6% of eligible pay will receive the maximum match of 4%. Contributions greater than 6% of eligible pay are not matched.

Employees become eligible to enter the plan immediately upon becoming age 18, and are immediately eligible for matching contributions. Matching contributions become 100% vested after only one year of service.

Retiree Medical Benefit Plan

The Company maintains a self-funded insurance plan for its employees and retirees. Employees who retired prior to January 1, 2003, or who retired with 30 years of service effective January 1, 2010 can maintain coverage in the insurance plan at reduced rates which are subsidized by the Company. Employees who retired prior to January 1, 1984 are exempt from paying premiums. Effective January 1, 2004, employees hired after January 1, 1999 will have access to the group health plan, but at full cost and without any Idaho Power contribution.
This plan is also available to non-employee directors of Idaho Power Company.

The Commission's Directive

Upon completion of Case No. IPC-E-10-08, where Idaho Power was allowed to recover approximately $5.4 million for its 2010 pension contribution, the Commission stated in Order No. 31091:

> Idaho Power is advised that, previous orders not withstanding, approval of the Company's pension contributions in this case does not guarantee Commission approval of future pension plan contributions. Authority for the balancing account and regulatory account remain in place. However, further justification is required before additional rate recovery for future contributions will be authorized. During the next three years, Idaho Power anticipates additional payments to its employee pension plan of approximately $68 million. Staff Comments, p. 4. During 2014-2018, that payments may total nearly $157 million *Id.* **It is unreasonable for Idaho Power's customers to be solely responsible for large contributions to the Company's defined benefit pension plan. Many employers in recent years have replaced their defined benefit plans with pension programs that place greater responsibility and investment risks on employees. Idaho Power must similarly consider changes to its retirement plan and address shareholder and employee liabilities in the assignment of pension plan investment risk.** The Commission will not approve recovery of additional pension plan contributions from customers without evidence that Idaho Power has carefully reviewed alternatives to reduce the burden placed on customers. [emphasis added][1]

[1] The statement in this Order that "During 2014-2018, the payments may total $157 million" mistakenly misinterprets Staff's comments to imply these payments represent expected plan contributions. Instead, the $157 million represents expected payments to retirees, which in turn reduce the assets of the pension plan trust and can potentially lead to larger contributions to replace those assets.

The language above clearly and definitively instructs the Company to review its defined benefit pension plan and consider changes to the plan to address the assignment of pension plan investment risk. Staff believes the directive by the Commission could not be more clear. Nonetheless, Company witness Said states in his Direct Testimony, pages 5-6 that his "read of the Commission Order language is that the Commission wants to refresh its understanding of the Company's management of retirement benefits package costs over time to ensure that such management is prudent and resulting costs are reasonable." Staff believes that, while a refresher is helpful, the Commission is aware of other retirement benefits provided by Idaho Power, as those benefits have been discussed in great detail in previous general rate cases. In Order No. 31091, the Commission specifically directed Idaho Power to address the cost to customers and assignment of investment risk associated with the defined benefit pension plan.

The Company merely reviewed its retirement benefits package in the same manner as it had done in the past, without altering its review and evaluation in light of the Commission's explicit directive. Both Mr. Anderson and Ms. Gerschultz testify that the instructions for the review of the retirement benefits package this year were similar to the instructions in prior years. Mr. Anderson's instructions to Ms. Gerschultz were "to provide the Office of the CEO with comparisons of the Company's overall retirement benefits package costs to a representative sample of comparable employers' retirement benefits package costs as a representative market." Direct Testimony at 5. He then "asked her to make recommendations for changes to the Company's retirement benefits package based upon the Company's desire to remain competitive to the representative employment market, but with an eye toward perpetuating a package which encourages employee retention," and "to recognize that retirement benefit portability is not in alignment with the Company's employee retention goals and may not be in the best interests of its customers." The instructions disregard the directive of the Commission to address the assignment of investment risk between shareholders and employees, and to review alternatives that reduce the burden placed on customers. Idaho Power's focus was fully on employee retention and not shareholder liabilities in the assignment of risk.

In response to Production Request No. 9 from the Industrial Customers of Idaho Power, the Company states that it "believes that shareholders of the Company are not willing to pay for costs associated with levels of pension plan investment risk that are greater than what would be found to be prudent and reasonably collected from customers." Apparently because Idaho Power predetermined that shareholders are unwilling to accept any of the investment risk associated with the defined benefit plan, the Company did not address the Commission's directive regarding allocation of risks in its evaluation. The Company further stated in that response that it "strives to operate the business in a cost-effective and prudent manner acceptable to regulators. More specifically, the Company reviews its Retirement Benefits Package annually to ensure these same operational objectives are met." The Company further stated that:

> Mr. Anderson's instructions to Ms. Gerschultz regarding her annual review of the Company's Retirement Benefits Package were not solely prompted by the Idaho Public Utilities Commission's directive in Order No. 31091. The Company believes it is appropriate to review its retirement benefits regardless of a Commission directive to do so. However, Mr. Anderson believes that his annual instructions to Ms. Gerschultz regarding evaluation of retirement benefits are consistent with Commission directives regarding such evaluation.

It is clear that the Company did not change its evaluation process based on the Commission directive, and instead focused on business as usual, and did not address the specific areas of concern discussed by the Commission.

Idaho Power mentions in its Application and testimonies that in reviewing the entire retirement benefits package, investment risk is allocated between the Company and the employees. The Application states that "the Company's three component approach to an overall retirement benefits package was specifically developed to balance the market risk between the Company and its retirees." Application, p. 5. The Company maintains that the investment risk with the 401(k) defined contribution plan and the inflationary risk with the retiree medical plan are borne by employees while the investment risk for the defined benefit pension plan is borne by the Company. However, it is misleading to state that the Company bears the investment risk of the defined benefit pension plan. The Company bears no investment risk because Commission Order No. 31003 allows for a regulatory balancing account for cash contributions and provides for the amortization of the balance in such account, including carrying charges. Given this regulatory authority, all investment risk associated with the defined benefit pension plan is borne by Idaho Power's customers. Staff believes it was this assignment of risk that prompted the Commission's directive to the Company in Order No. 31091 "to address shareholder and employee liabilities in the assignment of pension plan investment risk."

The Company also claims that avoidance of risk may also mean avoidance of any associated reward, and that customers have received rewards for bearing the risk of the defined benefit pension plan. In the twenty year period prior to the creation of a regulatory asset and balancing account established in Order No. 31003 for Case No. IPC-E-09-29, the Company has contributed approximately $26.5 million to the defined benefit plan while recovering approximately $44 million from customers in rates. In addition, the Company has capitalized nearly $8 million during that same period, and received a return on its investment and additional depreciation expense in rates. This illustrates that customers have not benefitted from the associated rewards of investment risk as pension costs embedded in rates exceeds the actual contributions to the pension plan trust.

The Company's Evaluation

In its annual review of the retirement benefits package, Idaho Power contracted with Towers Watson, using a benchmark analysis that compares the retirement benefits of 700 companies, including 92 energy industry companies. Idaho Power then compared its retirement benefits to a select group of 12 peer companies. Staff requested to see the benchmark analysis but the Company declined to provide it, stating that it was proprietary information to Towers Watson. The Company does indicate that the summary plan data for the comparable group of the 92 companies in the energy service industry illustrates that only 24 of them have a traditional defined benefit plan similar to Idaho Power's. Of the twelve companies in the peer group, only four have a defined benefit plan similar to Idaho Power's. Staff also asked to see this summary plan data, but it was not made available. Given this information, it is apparent that Idaho Power is one of the few remaining companies that maintain a traditional defined benefit plan. Staff believes it is unreasonable for Idaho Power to continue to place the burden of investment risk associated with traditional defined benefit plans squarely on the shoulders of customers.

Ms. Gerschultz explains the factors she considered in evaluating potential modifications to the Company's retirement package on page 7 of her Direct Testimony:

> The most important factor I considered was the independent market data that indicated that the Company was already below the representative employment market costs. I tried to balance this first factor with a second key factor that I considered – Mr. Anderson's detailed instructions that the Company should maintain a market competitive retirement benefits package. The final factor that I considered was the relative portability of different retirement options. Specifically, my focus was on the direction that I received from Mr. Anderson emphasizing that the retirement benefits package should encourage longevity in the Company's workforce to promote the retention of its skilled workers.

Ms. Gerschultz's evaluation and analysis of alternative plans seems entirely predicated on the concern that the Company's retirement benefits must encourage employee retention. The Company seems to summarily dismiss defined contribution plans from future consideration. Because the maximum vesting period allowed by law cannot exceed six years, and because defined contribution plans are fully portable upon termination of employment, the Company implies that defined contribution plans lead to higher employee turnover. However, the Company provides no evidence that portability of retirement benefits will lead to increased turnover. In fact, retention of employees is accomplished in many ways, and many times is outside the Company's control. Salaries, paid time off, work environment, corporate culture, and opportunity for advancement are all reasons for employees to remain with an employer that are within the employer's control. Other reasons, such as location, quality of life, spouse's employment, costs and variables in the housing market, and a good public school system are further reasons for Idaho Power's employees to remain with Idaho Power.

Idaho Power's argument that its retirement benefits package should promote retention by limiting portability is inconsistent with a primary feature in part of its retirement package. The matching contributions to the 401(k) plan become 100% vested after only one year of service. If employee retention is the main goal of Idaho Power's retirement benefits package, it arguably would warrant a far less generous vesting schedule on employer contributions. Staff also notes that the Company's turnover rate, excluding retirements, is 2%, a full percentage point less than the national average in 2009 according to the Bureau of Labor Statistics. This is evidence that turnover does not seem to be a significant issue for the Company.

Upon completion of its review, the Company decided to reduce the benefit formula in the pension plan from 1.5% per year of service to 1.2%, stating that once the workforce is fully transitioned, the Company will save approximately $1.97 million in annual pension costs. The Company suggests that customers will realize the savings immediately from the changes in the defined benefit pension plan. Customers will not realize an immediate benefit in 2011 because the changes only apply to new employees hired after January 1, 2011. The plan has a 12-month eligibility period before employees can participate, so there will be no savings at least until 2012. Because the changes only apply to new employees, and the Company must still fund the benefit accrual under the higher formula for existing employees, customers will not realize any material savings for several years. It could take 25-30 years for the workforce to be fully transitioned, meaning existing employees are no longer active in the plan, so the Company and customers will not realize the estimated $1.97 million benefit for quite a long time.

The Company prepared an analysis illustrating that if seven percent of pay were contributed to a defined contribution plan, it would provide the same level of retirement benefit as the existing defined benefit pension plan for the average employee. The average employee assumes an age 35 years old, an annual salary of $50,000 with a pay increase of three percent each year. The seven percent contributed would have to earn an annual return of eight percent to produce the same pay out as the defined pension plan. If five percent of compensation were contributed to the defined contribution plan, the employee would have to earn an average of ten percent on the investment to produce the equivalent pay out of the defined pension plan. Staff believes this demonstrates that the Company can provide the same level of retirement benefits for its employees without placing undue investment risk on its customers.

If employee retention is the primary goal of Idaho Power's retirement package, Staff believes there are many defined contribution plan formulas that may provide greater contributions to employees based on age, years of service, or position classification. Staff recommends that further evaluation of the retirement benefits package should include the option of a new comparability, cross-tested defined contribution plan, where older employees and employees in critical operations roles may receive a larger contribution than rank and file employees.

Staff is aware that the Commission does not intend to supersede the Company's operational decision-making process, and that the Company's directors are ultimately responsible for approving retirement benefits available to Idaho Power's employees. The Commission's responsibility is to determine the prudency and reasonableness of the retirement benefits package and the amounts recoverable from customers through rates. Staff believes this is why the Commission issued its order directing the Company to evaluate its defined benefit pension plan and consider alternatives that reduce the burden on customers and address shareholder and employee liabilities in the assignment of pension plan investment risk. As stated previously, the Company's modified pension plan does very little to reduce the burden on customers, and the assignment of investment risk was not seriously addressed in the evaluation.

STAFF RECOMMENDATION

After reviewing the Application, testimony, and all other information made available, Staff recommends that the Commission reject the Company's request for acceptance of its retirement benefit package evaluation with implied inclusion in future rates. Staff also recommends that the Commission direct Idaho Power, in future evaluations, to provide Staff all requested information in its entirety without redaction. Idaho Power should inform its third party consultants of expected Commission reviews prior to engaging those third party's services, and remind them of the Commission's right to review relevant information.

Respectfully submitted this 14th day of December 2010.

Weldon B. Stutzman
Deputy Attorney General

Technical Staff: Terri Carlock
Donn English

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 14TH DAY OF DECEMBER 2010, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. IPC-E-10-25, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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