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May 31, 2007

VIA ELECTRONIC FILING

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: Docket No. UM 1276

Enclosed for filing in the above-referenced proceeding are Idaho Power Company's Comments on Parties' Straw Proposals. A copy of this filing has been served on all parties to this proceeding as indicated on the attached service list.

Very truly yours,

A handwritten signature in black ink, appearing to read "Lisa Rackner", with a long horizontal flourish extending to the right.

Lisa F. Rackner

Enclosure

cc: Service List

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**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1276

In the Matter of THE PUBLIC UTILITY
COMMISSION OF OREGON Staff's request
to open an investigation regarding
performance-based ratemaking
mechanisms to address potential build-vs.-
buy bias.

**COMMENTS OF IDAHO POWER
ON PARTIES' STRAW PROPOSALS**

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I. INTRODUCTION

Idaho Power Company ("Idaho Power" or the "Company") appreciates all of the thought and work that the parties have contributed to the development of the Straw Proposals, and particularly appreciates the willingness of NIPPC, ICNU, PacifiCorp and PGE to sponsor the drafting of specific of the proposals. The Company has long considered the rating agencies' practice of imputing debt for Power Purchase Agreements ("PPAs") to be problematic, and believes that the Commission goals in this docket are worthwhile. Idaho Power has reviewed all proposals with interest and finds merit in several. That said, the Company believes that two particular proposals hold the most promise: PGE's Debt Imputation ("DI") Proposal, and PacifiCorp's Conservation Incentive Model for Purchased Power ("CIM/pp"). Accordingly, Idaho Power offers the following comments on those two proposals.

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II. DISCUSSION

A. PGE's Debt Imputation Proposal

Of all the proposals, PGE's DI Proposal most simply and directly addresses the disincentive to enter into PPAs created by the rating agencies' practice of debt imputation. By determining the debt imputed by the rating agencies for PPAs, and adding an equal amount of equity to the capital structure of the utility for ratemaking purposes, the DI

1 Proposal measures and offsets the perceived "harm" of debt imputation. Moreover, the DI
2 Proposal's suggested method for calculating the amount of equity to be "imputed" to the
3 utility's financial structure is one that will be relatively easy to administer and therefore
4 should result in few disputes. Because the calculation is made for ratemaking purposes
5 only it will not affect the utility's on-going accounting. Idaho Power, therefore, fully supports
6 the DI Proposal.

7 Idaho Power does observe that because it does not have a power cost adjustment
8 ("PCAM") or any other mechanism that regularly updates power costs in rates, the DI
9 Proposal allows for significant regulatory lag between a possible debt imputation by the
10 rating agencies and "equity imputation" by the Commission. The Company looks forward to
11 discussing this issue further at the June workshop in hopes of developing a solution that will
12 address Idaho Power's specific circumstances.

13 **B. PacifiCorp's CIM/pp Proposal**

14 PacifiCorp's CIM/pp Proposal also presents a sound method for balancing out the
15 impact of the rating agencies' debt imputation practices by presenting the utility with the
16 opportunity to earn a return on PPA obligations. Of all of the proposals, it is the most
17 transparent for reporting purposes.

18 PacifiCorp's CIM/pp Proposal is however, more complex than PGE's DI Proposal,
19 and would involve significantly more work to implement. Specifically, at the next workshop,
20 Idaho Power would look forward to discussing the following issues raised by the CIM/pp
21 Proposal:

- 22 1. The CIM/pp Proposal is specifically linked to the Standard & Poor's ("S&P") debt
23 imputation methodology, and PacifiCorp proposes to adopt S&P's particular
24 methodology for calculating the net present value ("NPV") of the capacity portion
25 of the PPAs. Experience tells us that S&P's metrics are not completely
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1 transparent. For instance, based on S&P's most recent guidance¹, there appears
2 to be significant discretion involved in the identification of the "risk factor" to be
3 applied to a utility's PPAs. This could leave the application of the CIM/pp subject
4 to disputes. Experience also tells us that S&P's metrics are subject to change,
5 and for that reason, the utilities could find themselves with several different
6 tranches of capitalized PPAs that would need to be "trued-up" each time S&P
7 makes a change. Additionally, Idaho Power believes that each PPA would need
8 to be accounted for separately because each will have a different life. The
9 parties should discuss how the Commission might approach S&P's sometimes
10 opaque and changing methodologies and whether more concrete metrics might
11 be used as a point of reference.

12 2. The CIM/pp Proposal uses Allowance for Funds used for PPAs ("AFPPA") which
13 is calculated as using the utility's post-tax Allowance for Funds Used During
14 Construction ("AFUDC") rate until the capitalized amounts are included in rates.
15 After the capitalized funds are included in rates, a pre-tax carrying charge is
16 calculated on the amortization of the capacity portion of the PPA. As is the case
17 with respect to the DI Proposal, for a utility without a PCAM, the regulatory lag
18 could be quite significant. Moreover, by using the AFUDC rate, the Proposal
19 links the recovery or return to the existing Construction Work in Progress
20 ("CWIP") or short-term debt balances at any given time. The parties should
21 discuss how the regulatory lag might be dealt with in the absence of a PCAM.

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25 ¹ Attached as Exhibit 1 to these Comments is S&P's most recent report on its methodology
26 for imputing debt for PPAs.

1 **III. CONCLUSION**

2 As stated above, Idaho Power believes that both PGE's DI Proposal and PacifiCorp's
3 CIM/pp Proposal could effectively address the disincentive to enter into PPAs caused by the
4 rating agencies' practice of debt imputation. The DI Proposal simply and directly offsets the
5 effect of the debt imputation by making an equivalent and opposite "equity imputation" in the
6 utility's financial structure for ratemaking purposes. The CIM/pp proposal takes a different
7 approach, but similarly offers the utility an opportunity to earn an income stream from the
8 PPAs in order to compensate the utility for the negative effect of the debt imputation.
9 However, of the two, Idaho Power prefers the DI Proposal, for its administrative simplicity.
10 While the CIM/pp Proposal is an intriguing one, the complexity of the Proposal gives Idaho
11 Power pause, particularly given the Company's limited presence in the state.

12 That said, a one-size-fits-all solution is not a required outcome for this docket. On
13 the contrary, the best outcome might be for the Commission to approve alternative
14 mechanisms, and allow the utilities to choose the one that makes the most sense given its
15 particular circumstances. In this way, the Commission could be best assured that it was
16 providing each utility with the most effective incentive to realize Commission objectives. The
17 Commission has recognized "a mechanism can only be an incentive if the entity sought to
18 be encouraged to views it as an incentive."² Thus, if the Commission agrees that more than
19 one Proposal is acceptable, the utilities would be best incented to enter into PPAs by a
20 mechanism of their own choosing.

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25 ² *Re Electric Utility Incentives for Acquisition of Conservation Resources*, UM 409, Order
26 No. 92-1673.

1 Idaho Power looks forward to the opportunity to continue to work with the parties on
2 the various Proposals at the June workshop.

3 DATED: May 31, 2007.

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EXHIBIT 1

RESEARCH

Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements

Publication date: 07-May-2007
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For many years, Standard & Poor's Ratings Services has viewed power supply agreements (PPA) in the U.S. utility sector as creating fixed, debt-like, financial obligations that represent substitutes for debt-financed capital investments in generation capacity. In a sense, a utility that has entered into a PPA has contracted with a supplier to make the financial investment on its behalf. Consequently, PPA fixed obligations, in the form of capacity payments, merit inclusion in a utility's financial metrics as though they are part of a utility's permanent capital structure and are incorporated in our assessment of a utility's creditworthiness.

We adjust utilities' financial metrics, incorporating PPA fixed obligations, so that we can compare companies that finance and build generation capacity and those that purchase capacity to satisfy customer needs. The analytical goal of our financial adjustments for PPAs is to reflect fixed obligations in a way that depicts the credit exposure that is added by PPAs. That said, PPAs also benefit utilities that enter into contracts with suppliers because PPAs will typically shift various risks to the suppliers, such as construction risk and most of the operating risk. PPAs can also provide utilities with asset diversity that might not have been achievable through self-build. The principal risk borne by a utility that relies on PPAs is the recovery of the financial obligation in rates.

The Mechanics Of PPA Debt Imputation

A starting point for calculating the debt to be imputed for PPA-related fixed obligations can be found among the "commitments and contingencies" in the notes to a utility's financial statements. We calculate a net present value (NPV) of the stream of the outstanding contracts' capacity payments reported in the financial statements as the foundation of our financial adjustments.

The notes to the financial statements enumerate capacity payments for the five years succeeding the annual report and a "thereafter" period. While we have access to proprietary forecasts that show the detail underlying the costs that are amalgamated beyond the five-year horizon, others, for purposes of calculating an NPV, can divide the amount reported as "thereafter" by the average of the capacity payments in the preceding five years to derive an approximate tenor of the amounts combined as the sum of the obligations beyond the fifth year.

In calculating debt equivalents, we also include new contracts that will commence during the forecast period. Such contracts aren't reflected in the notes to the financial statements, but relevant information regarding these contracts are provided to us on a confidential basis. If a contract has been executed but the energy will not flow until some later period, we won't impute debt for that contract until the year that energy deliveries begin under the contract if the contract represents incremental capacity. However, to the extent that the contract will simply replace an expiring contract, we will impute debt as though the future contract is a continuation of the existing contract.

We calculate the NPV of capacity payments using a discount rate equivalent to the company's average cost of debt, net of securitization debt. Once we arrive at the NPV, we apply a risk factor, as is discussed below, to reflect the benefits of regulatory or legislative cost recovery mechanisms.

Balance sheet debt is increased by the risk-factor-adjusted NPV of the stream of capacity payments. We derive an adjusted debt-to-capitalization ratio by adding the adjusted NPV to both the numerator and the denominator of that ratio.

We calculate an implied interest expense for the imputed debt by multiplying the same utility average cost of debt used as the discount rate in the NPV calculation by the amount of imputed debt. The adjusted FFO-to-interest expense ratio is calculated by adding the implied interest expense to both the numerator and denominator of the equation. We also add implied depreciation to the equation's numerator. We calculate the adjusted FFO-to-total-debt ratio by adding imputed debt to the equation's denominator and an implied depreciation expense to its numerator.

Our adjusted cash flow credit metrics include a depreciation expense adjustment to FFO. This adjustment represents a vehicle for capturing the ownership-like attributes of the contracted asset and tempers the effects of imputation on the cash flow ratios. We derive the depreciation expense adjustment by multiplying the relevant year's capacity payment obligation by the risk factor and then subtracting the implied PPA-related interest expense for that year from the product of the risk factor times the scheduled capacity payment.

Risk Factors

The NPVs that Standard & Poor's calculates to adjust reported financial metrics to capture PPA capacity payments are multiplied by risk factors. These risk factors typically range between 0% to 50%, but can be as high as 100%. Risk factors are inversely related to the strength and availability of regulatory or legislative vehicles for the recovery of the capacity costs associated with power supply arrangements. The strongest recovery mechanisms translate into the smallest risk factors. A 100% risk factor would signify that all risk related to contractual obligations rests on the company with no mitigating regulatory or legislative support.

For example, an unregulated energy company that has entered into a tolling arrangement with a third-party supplier would be assigned a 100% risk factor. Conversely, a 0% risk factor indicates that the burden of the contractual payments rests solely with ratepayers. This type of arrangement is frequently found among regulated utilities that act as conduits for the delivery of a third party's electricity and essentially deliver power, collect charges, and remit revenues to the suppliers. These utilities have typically been directed to sell all their generation assets, are barred from developing new generation assets, and the power supplied to their customers is sourced through a state auction or third parties, leaving the utilities to act as intermediaries between retail customers and the electricity suppliers.

Intermediate degrees of recovery risk are presented by a number of regulatory and legislative mechanisms. For example, some regulators use a utility's rate case to establish base rates that provide for the recovery of the fixed costs created by PPAs. Although we see this type of mechanism as generally supportive of credit quality, the fact remains that the utility will need to litigate the right to recover costs and the prudence of PPA capacity payments in successive rate cases to ensure ongoing recovery of its fixed costs. For such a PPA, we employ a 50% risk factor. In cases where a regulator has established a power cost adjustment mechanism that recovers all prudent PPA costs, we employ a risk factor of 25% because the recovery hurdle is lower than it is for a utility that must litigate time and again its right to recover costs.

We recognize that there are certain jurisdictions that have true-up mechanisms that are more favorable and frequent than the review of base rates, but still don't amount to pure pass-through mechanisms. Some of these mechanisms are triggered when certain financial thresholds are met or after prescribed periods of time have passed. In these instances, in calculating adjusted ratios, we will employ a risk factor between the revised 25% risk factors for utilities with power cost adjustment mechanisms and 50%.

Finally, we view legislatively created cost recovery mechanisms as longer lasting and more resilient to change than regulatory cost recovery vehicles. Consequently, such mechanisms lead to risk factors between 0% and 15%, depending on the legislative provisions for cost recovery and the supply function borne by the utility. Legislative guarantees of complete and timely recovery of costs are particularly important to achieving the lowest risk factors.

Illustration Of The PPA Adjustment Methodology

The calculations of the debt equivalents, implied interest expense, depreciation expense, and adjusted financial metrics, using risk factors, are illustrated in the following example:

Example Of Power-Purchase Agreement Adjustment							
(\$000s)	Assumption	Year 1	Year 2	Year 3	Year 4	Year 5	Thereafter
Cash from operations	2,000,000						
Funds from operations	1,500,000						
Interest expense	444,000						
Directly issued debt							
Short-term debt	600,000						
Long-term due within one year	300,000						
Long-term debt	6,500,000						
Shareholder's Equity	6,000,000						
Fixed capacity commitments	600,000	600,000	600,000	600,000	600,000	600,000	4,200,000*
NPV of fixed capacity commitments							
Using a 6.0% discount rate	5,030,306						
Application of an assumed 25% risk factor	1,257,577						
Implied interest expense [§]	75,455						
Implied depreciation expense	74,545						
Unadjusted ratios							
FFO to interest (x)	4.4						
FFO to total Debt (%)	20.0						
Debt to capitalization (%)	55.0						
Ratios adjusted for debt imputation							
FFO to interest (x) [§]	4.0						
FFO to total debt (%)**	18.0						
Debt to capitalization (%) ^{¶¶}	59.0						

*Thereafter approximate years: 7. [§]The current year's implied interest is subtracted from the product of the risk factor multiplied by the current year's capacity payment. [§]Adds implied interest to the numerator and denominator and adds implied depreciation to FFO.
^{**}Adds implied depreciation expense to FFO and implied debt to reported debt. ^{¶¶}Adds implied debt to both the numerator and the denominator. FFO--Funds from operations. NPV--Net present value.

Short-Term Contracts

Standard & Poor's has abandoned its historical practice of not imputing debt for contracts with terms of three years or less. However, we understand that there are some utilities that use short-term PPAs of approximately one year or less as gap fillers pending the construction of new capacity. To the extent that such short-term supply arrangements represent a nominal percentage of demand and serve the purposes described above, we will neither impute debt for such contracts nor provide evergreen treatment to such contracts.

Evergreen Treatment

The NPV of the fixed obligations associated with a portfolio of short-term or intermediate-term contracts can lead to distortions in a utility's financial profile relative to the NPV of the fixed obligations of a utility with a portfolio of PPAs that is made up of longer-term commitments. Where there is the potential for such distortions, rating committees will consider evergreen treatment of existing PPA obligations as a scenario for inclusion in the rating analysis. Evergreen treatment extends the tenor of short- and intermediate-term contracts to reflect the long-term obligation of electric utilities to meet their customers' demand for electricity.

While we have concluded that there is a limited pool of utilities whose portfolios of existing and projected PPAs don't meaningfully correspond to long-term load serving obligations, we will nevertheless apply evergreen treatment in those cases where the portfolio of existing and projected PPAs is inconsistent with long-term load-serving obligations. A blanket application of evergreen treatment is not warranted.

To provide evergreen treatment, Standard & Poor's starts by looking at the tenor of outstanding PPAs. Others can look to the "commitments and contingencies" in the notes to a utility's financial statements to derive an approximate tenor of the contracts. If we conclude that the duration of PPAs is short relative to our targeted tenor, we would then add capacity payments until the targeted tenor is achieved. Based on our analysis of several companies, we have determined that the evergreen extension of the tenor of existing contracts and anticipated contracts should extend contracts to a common length of about 12 years.

The price for the capacity that we add will be derived from new peaker entry economics. We use empirical data to establish the cost of developing new peaking capacity and reflect regional differences in our analysis. The cost of new capacity is translated into a dollars per kilowatt-year (kW-year) figure using a weighted average cost of capital for the utility and a proxy capital recovery period.

Analytical Treatment Of Contracts With All-In Energy Prices

The pricing for some PPA contracts is stated as a single, all-in energy price. Standard & Poor's considers an implied capacity price that funds the recovery of the supplier's capital investment to be subsumed within the all-in energy price. Consequently, we use a proxy capacity charge, stated in \$/kW, to calculate an implied capacity payment associated with the PPA. The \$/kW figure is multiplied by the number of kilowatts under contract. In cases of resources such as wind power that exhibit very low capacity factors, we will adjust the kilowatts under contract to reflect the anticipated capacity factor that the resource is expected to achieve.

We derive the proxy cost of capacity using empirical data evidencing the cost of developing new peaking capacity. We will reflect regional differences in our analysis. The cost of new capacity is translated into a \$/kW figure using a weighted average cost of capital and a proxy capital recovery period. This number will be updated from time to time to reflect prevailing costs for the development and financing of the marginal unit, a combustion turbine.

Transmission Arrangements

In recent years, some utilities have entered into long-term transmission contracts in lieu of building generation. In some cases, these contracts provide access to specific power plants, while other transmission arrangements provide access to competitive wholesale electricity markets. We have concluded that these types of transmission arrangements represent extensions of the power plants to which they are connected or the markets that they serve. Irrespective of whether these transmission lines are integral to the delivery of power from a specific plant or are conduits to wholesale markets, we view these arrangements as exhibiting very strong parallels to PPAs as a substitute for investment in power plants. Consequently, we will impute debt for the fixed costs associated with long-term transmission contracts.

PPAs Treated As Leases

Several utilities have reported that their accountants dictate that certain PPAs need to be treated as leases for accounting purposes due to the tenor of the PPA or the residual value of the asset upon the PPA's expiration. We have consistently taken the position that companies should identify those capacity charges that are subject to operating lease treatment in the financial statements so that we can accord PPA treatment to those obligations, in lieu of lease treatment. That is, PPAs that receive operating lease treatment for accounting purposes won't be subject to a 100% risk factor for analytical purposes as though they were leases. Rather, the NPV of the stream of capacity payments associated with these PPAs will be reduced by the risk factor that is applied to the utility's other PPA commitments. PPAs that are treated as capital leases for accounting purposes will not receive PPA treatment because capital lease treatment indicates that the plant under contract economically "belongs" to the utility.

Evaluating The Effect Of PPAs

Though history is on the side of full cost recovery, PPAs nevertheless add financial obligations that heighten financial risk. Yet, we apply risk factors that reduce debt imputation to recognize that utilities that rely on PPAs transfer significant risks to ratepayers and suppliers.

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CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in Docket UM 1276 on the following named person(s) on the date indicated below by email and first-class mail addressed to said person(s) at his or her last-known address(es) indicated below.

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