

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-09 _____

DOCKET NO. UG-09 _____

DIRECT TESTIMONY OF

SCOTT L. MORRIS

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

Q. Please state your name, employer and business address.

A. My name is Scott L. Morris and I am employed as the Chairman of the Board, President, and Chief Executive Officer of Avista Corporation (Company or Avista), at 1411 East Mission Avenue, Spokane, Washington.

Q. Would you briefly describe your educational background and professional experience?

A. Yes. I am a graduate of Gonzaga University with a Bachelors degree and a Masters degree in organizational leadership. I have also attended the Kidder Peabody School of Financial Management.

I joined the Company in 1981 and have served in a number of roles including customer service manager. In 1991, I was appointed general manager for Avista Utilities' Oregon and California natural gas utility business. I was appointed President and General Manager of Avista Utilities, an operating division of Avista Corporation, in August 2000. In February 2003, I was appointed Senior Vice-President of Avista Corporation, and in May 2006, I was appointed as President and Chief Operating Officer. Effective January 1, 2008, I assumed the position of Chairman of the Board, President, and Chief Executive Officer.

I am a member of the Western Energy Institute board of directors, a member of the Gonzaga University board of trustees, a member of Edison Electric Institute board of directors, a member of the American Gas Association board of directors, a member of ReliOn board of directors, and board director of the Washington Roundtable. I also serve on the board of trustees

1 of the Greater Spokane Incorporated, which was formerly two separate organizations, the Spokane
 2 Area Economic Development Council and the Spokane Regional Chamber of Commerce.

3 **Q. What is the scope of your testimony in this proceeding?**

4 A. I will provide an overview of Avista Corporation and Avista Utilities. I summarize
 5 the Company's rate requests in this filing, and the primary factors driving the Company's need for
 6 general rate relief. I will provide an overview of some of the initiatives that we have undertaken in
 7 recent years to achieve operating efficiencies in an effort to mitigate a portion of the increase in
 8 costs that Avista, as well as other utilities in the industry are experiencing. I will also briefly
 9 explain the Company's customer support programs that are in place to assist our customers.
 10 Finally, I will introduce each of the other witnesses providing testimony on the Company's behalf.

11 A table of contents for my testimony is as follows:

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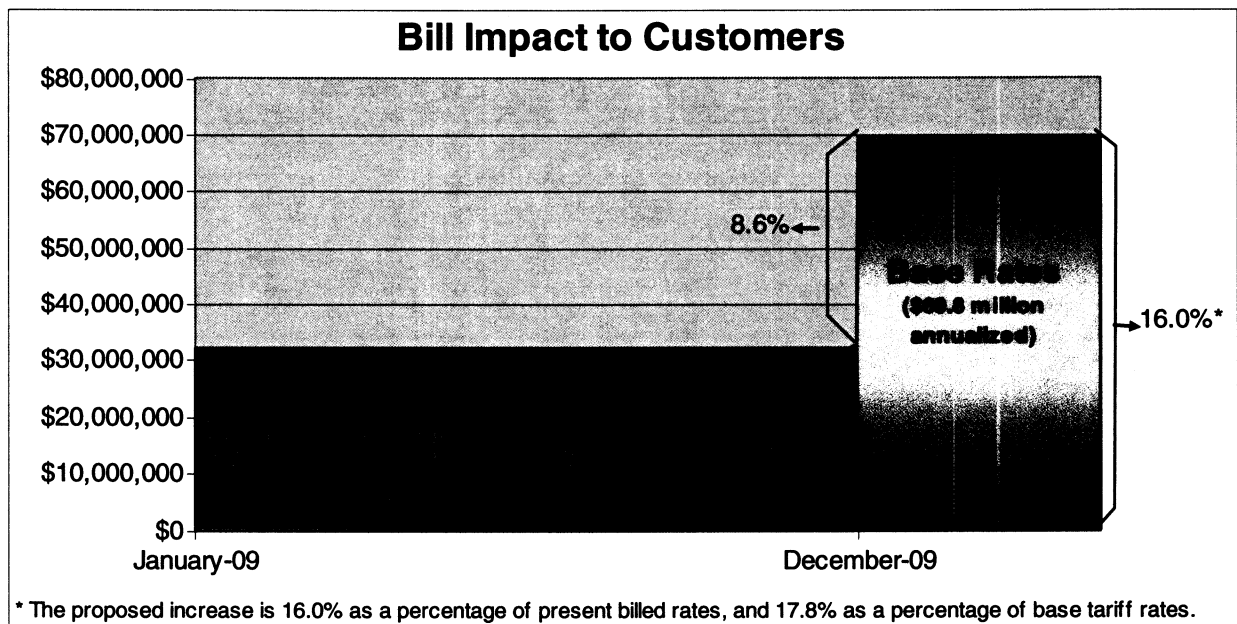
22
 23
 24 **Q. Are you sponsoring any exhibits in this proceeding?**

25 A. Yes. I am sponsoring Exhibit No. ____ (SLM-2), pages 1 through 2. Page 1 is a
 26 diagram of Avista's corporate structure; and page 2 includes a map showing Avista's electric and
 27 natural gas service areas. This exhibit was prepared under my direction.

28 **Q. Please summarize the proposed changes in retail rates in this filing.**

1 A. In this filing Avista is proposing a net increase in electric retail rates of 8.6%. The
 2 proposal consists of an increase in electric base retail rates of \$69.8 million or 16.0%, and a
 3 reduction in the current Energy Recovery Mechanism (ERM) surcharge of 7.4%. We are
 4 proposing that a reduction in the current ERM surcharge to zero occur at the time the general rate
 5 increase is implemented. Company witness Mr. Hirschhorn's testimony discusses this change in
 6 the ERM surcharge. Therefore, the proposed electric increase to customers from this filing is a net
 7 increase of 8.6%. The proposed natural gas increase in the filing is \$ 4.9 million, or 2.3%. The
 8 following illustrates how the estimated electric net increase was derived.

9 **Illustration No. 1:**



18 **II. COST DRIVERS FOR AVISTA**

19 **Q. Why is Avista proposing another electric revenue increase following the**
 20 **recent general rate request?**

1 A. This case is about more than just year-over-year changes in utility
2 operating costs, such as power costs, fuel, materials and supplies, and labor. We are also
3 investing large amounts of capital to preserve and upgrade our existing utility
4 infrastructure to meet growing customer demand. We are also continuing to experience
5 major cost impacts related to meeting new reliability standards, environmental
6 compliance, and litigation related to the preservation of what have historically been our
7 low-cost resources we have used for decades to serve our customers. Several examples
8 of significant cost increases are as follows:

9 1. **Compensation to the Coeur d' Alene Tribe (Tribe):**

10 The recently announced Settlement Agreement among the Tribe, Avista, and the U.S.
11 Department of Interior, provides compensation to the Tribe related to their ownership
12 of the Southern one-third of Lake Coeur d' Alene (CDA). Although these costs were
13 reviewed in the prior general rate case, they were deferred for future recovery in a
14 subsequent rate case and are included in the current filing. The annual cost to
15 Washington customers from this Agreement is \$3.1 million, or a 0.8% increase in
16 base retail rates.

17
18 2. **Spokane River Relicensing:** The resolution of issues with the CDA Tribe helps
19 clear the way for the Federal Energy Regulatory Commission (FERC) to issue a new
20 license for the Post Falls Hydroelectric Project in the State of Idaho. There is,
21 however, one remaining issue for the Projects in the State of Washington related to
22 water quality. We expect this issue to be resolved in the first half of 2009 and a new
23 license to be issued. The majority of the relicensing costs were reviewed in the prior
24 general rate case filing, but were deferred for later recovery in this filing. The annual
25 cost to Washington customers from relicensing the Spokane River Projects is \$6.7
26 million, or a 1.7% increase in base retail rates.

27
28 3. **Mitigation of Mercury and Thermal O&M Cost Increases:** During 2009, the
29 Colstrip owners, including Avista, will begin to incur significant costs to comply with
30 new Mercury emissions laws in the State of Montana. Avista is also experiencing a
31 significant increase in O&M at its thermal plants, due in part to the rapid increase in
32 the cost of materials and the age of the plants. The increase in annual costs is \$3.4
33 million, or a 0.9% increase in base retail rates.

1 4. **Increase in Power Supply Costs:** The increase in costs is driven by, among other
2 things, the expiration of low-cost Mid-Columbia contracts, the increase in net expense
3 due to the addition of the Lancaster plant Power Purchase Agreement (PPA), and an
4 increase in retail loads. Although the economy has slowed, the growth of energy
5 demands by customers continues to climb, we believe due in part to a continuing
6 increase in televisions, computers, cell phone chargers, and other consumer
7 electronics in customers' homes. The increase in annual power supply costs is \$18.1
8 million, or a 4.6% increase in base retail rates.

9
10 5. **Investment in Facilities to Serve Customers:** As other witnesses will explain in
11 more detail, we are continuing to invest significant dollars in utility infrastructure.
12 The investment is necessary to serve new customers, upgrade aging facilities – some
13 of which are over 70 years old - and meet recently-enacted reliability requirements for
14 our energy delivery facilities. Although in recent months the rapid increase in the cost
15 of materials (concrete, copper, steel, etc.) has abated, such costs are still orders of
16 magnitude higher than what they were even a few years ago. New investment
17 reflected in this filing results in an increase in annual costs to customers of \$6.7
18 million, or a 1.7% increase in base retail rates.

19
20 These items alone total \$38 million, representing an increased revenue requirement of
21 9.7% for the Washington jurisdiction, prior to even addressing other utility ownership and
22 operating costs.

23 In a November 2008 report prepared by the Brattle Group for The Edison Foundation,
24 “Transforming America's Power Industry: The Investment Challenge 2010-2030.” It states, at
25 page v:

26 The U.S. electric utility industry is facing the greatest challenge in its history. The
27 demand for electric service is increasing, reserve margins are shrinking and input costs to
28 build infrastructure for all types of electricity production are soaring. Global climate
29 change and other environmental issues are directing the industry toward greater
30 development and use of energy efficiency products and services and low-emissions
31 supply sources, all of which come with costs.

32
33 We are a low-cost utility in the midst of a high-cost environment: high cost of materials
34 for utility infrastructure, high fuel and purchased power costs, high cost of compliance with

1 environmental and reliability requirements, and, recently, high costs to settle long-standing
2 litigation (CDA Tribe/Relicensing and Montana Riverbed litigation). This is all in the face of
3 increased demands for service by our customers – and we need to meet those needs by providing
4 safe, reliable and efficient service.

5 **III. COST MANAGEMENT AND EFFICIENCIES**

6 **Q. What is Avista doing to mitigate the impact of increased costs on its**
7 **customers?**

8 A. We recognized that these increases in costs will result in electric bills that will be
9 more difficult for some of our customers to pay. I can assure you that we are not just sitting on the
10 sidelines as our costs go up.

11 I will explain a number of cost-cutting and efficiency measures that we have undertaken
12 recently in an effort to mitigate the overall cost impacts to our customers. In addition, we have a
13 history of making it a priority within our Company to maintain meaningful programs to assist our
14 customers that are least able to pay their energy bills, including working cooperatively with our
15 local community action agencies.

16 We will continue to aggressively manage costs to achieve the appropriate balance in
17 providing safe and reliable service at cost-effective rates, and a high level of customer satisfaction,
18 while preserving the financial health of the utility.

19 **Q. What measures has the Company taken?**

20 A. The measures below are among some of the actions we have taken to mitigate the
21 impact of increased costs on our customers:

- 1 **1. Delayed the Reardan Wind Project.** We have recently delayed the construction of the
2 \$125+ million Reardan Wind Project to 2013, due, in part, to the current high cost of
3 wind turbines and other materials.
4
- 5 **2. Cancelled Ross Court Office Space.** Avista's main office building was constructed in
6 1958, and expanded in 1978. Even though Avista's ratio of the number of customers
7 served per employee continues to increase, we have needed additional office space for
8 some time. In 2008, in order to reduce costs, we cancelled plans to build additional
9 office space adjacent to the main office, and instead chose to remodel existing space
10 formerly used by Horizon Credit Union nine miles from the main office.
11
- 12 **3. Outsourced Billing and Disaster Recovery.** Avista recently outsourced its bill
13 printing and mailing services, and at the same time complying with requirements
14 related to disaster-recovery for billing data. The objectives were to move bill printing,
15 inserting and mailing offsite and leverage core competencies of the provider, to obtain
16 disaster recovery and avoid the cost of duplicate data storage, ensure daily print volume
17 flexibility, and reduce costs for bill printing, inserting and mailing.
18
- 19 **4. Additional On-line Service Offerings.** In January 2008 the Company completed the
20 redesign of *www.avistautilities.com*. The primary objectives of this project were to
21 lower costs and enhance customer satisfaction through the deployment of additional
22 self- service options, such as open/close/move, reporting and making payment
23 arrangements, enrolling in Comfort Level Billing, and/or Automatic Payment Service
24 (APS). Customers also have access to tools to help analyze their bills and are provided
25 with meaningful information to make informed energy management choices. The cost-
26 saving objective is to achieve a 10% reduction in the Company's Contact Center total
27 call volume, which results in lower staffing and lower costs to customers.
28

29
30 **Q. Are these the only measures the Company has taken recently to mitigate**
31 **increased costs?**

32 **A. No.** Avista is constantly looking for improvements in the way it provides services
33 to its customers, as well as ways to reduce the costs of those services. Ideas are generated
34 through periodic evaluation of its operating practices, and communications with other utilities,
35 and other industry participants, across the country on best practices. While a later witness, Mr.
36 Kopczynski, will explore cost-saving initiatives in more detail, I would like to highlight a few:
37

- 1 **1. Mobile Dispatch.** The Mobile Dispatch Project achieved a number of financial and
2 customer service benefits, including increased productivity, enhanced customer
3 service, reduced costs, and improved field safety. This project uses wireless
4 communications between the home office and laptop computer in service trucks to
5 dispatch field crews. These capabilities allow for efficient order dispatch, enhanced
6 customer service with efficient order booking, improved safety, and reduced costs to
7 perform the work.
8
- 9 **2. Outage Management.** The Outage Management tool is linked to the Company's
10 Geographic Information System (GIS mapping system). It allows the Company's
11 distribution facilities to be linked to individual customer service points in a computer
12 based model. The connectivity provides tools to determine outage areas and affected
13 protective devices. Accurate outage data can be collected for all incidents providing
14 feedback to improve reliability and outage statistics which can be monitored in real
15 time to indicate the severity of major events and assist in resource planning. These
16 capabilities allow for quicker restoration of electrical service for our customers,
17 thereby reducing labor expenses and enhancing customer service.
18
- 19 **3. Regional Infrastructure Efficiency.** Prior to the construction season each year,
20 Avista, in partnership with the City of Spokane, hosts Spokane's Joint Utilities
21 Coordination Council to bring together regional municipalities, utility companies,
22 telecommunications providers, sewer, water and the railroad to coordinate
23 construction activities. Municipalities and utilities share their project plans and
24 schedules so as to increase the coordination and mitigate the risk of unknown
25 projects. The efforts of the Joint Utilities Coordination Council have resulted in
26 greater coordination and efficiencies across the Spokane region.
27

28
29 **Q. Has Avista considered additional measures to mitigate increased costs?**

30 **A.** Yes. In fact we are currently in the process of revisiting our capital budget for
31 2009 for potential cuts. With regard to operating expenses, in recent years Avista has run its
32 operations with attention to minimizing expenses while providing reliable service and a high
33 level of customer satisfaction. Following the energy crisis of 2000/2001, we cut our operating
34 expenses as we worked toward regaining an investment grade credit rating. Since that time we
35 have continued to pay particular attention to limiting the growth in these costs, while meeting

1 important reliability and environmental compliance requirements, and preserving a high level of
2 customer satisfaction.

3

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IV. CUSTOMER SUPPORT PROGRAMS

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Q. What is Avista doing to assist customers with their energy bills?

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A. As I mentioned earlier, we have a history of making it a priority within our Company to maintain meaningful programs to assist our customers that are least able to pay their energy bills. We also have programs to assist our entire customer base, i.e., not just our low-income customers. Some of the key programs that we offer or support are as follows:

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1. **Low-Income Rate Assistance Program (LIRAP).** Avista's Low Income Rate Assistance Program collects approximately \$3.75 million per year through electric and natural gas tariff surcharges. The Company, with the assistance of community action agencies, directs these funds to customers least able to pay for electric and natural gas service. The purpose of the LIRAP program is to reduce the energy cost burden among those customers least able to pay energy bills. In the 2007/2008 heating period for example, the Company was able to give close to 6,700 grants to our customers.

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2. **Increased DSM Programs and Funding.** In January 2008 Avista proposed, and the WUTC approved, modifications to the Company's energy efficiency program offerings. The modifications further broadened the technical and financial support Avista provides to its customers, and provides customers with increased opportunity to manage their energy bills. In 2008 Avista also launched the award-winning "Every Little Bit" energy efficiency promotional campaign which integrates all of the Company's energy efficiency programs into one location.

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3. **Project Share.** Project Share is a voluntary program allowing customers to donate funds that are distributed through community action agencies to customers in need. In addition to the customer and employee contributions of \$161,204 (through December 2008) in Washington, the Company contributed \$205,350, Washington's share, to the program in 2008.

33

34

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4. **Comfort Level Billing.** The Company offers the option for all customers to pay the same bill amount each month of the year by averaging their annual usage. Under this program, customers can avoid unpredictable winter heating bills.

- 1 5. **Payment Arrangements.** The Company's Contact Center Representatives work with
2 customers to set up payment arrangements to pay energy bills.
3
- 4 6. **CARES Program.** Customer Assistance Referral and Evaluation Services provides
5 assistance to special-needs customers through access to specially trained (CARES)
6 representatives who provide referrals to area agencies and churches for help with
7 housing, utilities, medical assistance, etc.
8
- 9 7. **Customer Service Automation.** Customers are able to access Avista's Interactive
10 Voice Response system (IVR) for automated transactions to enter their own payment
11 arrangements, listen to outage messages and conduct other business such as obtaining
12 account balances and requesting a duplicate bill.
13
- 14 8. **Power to Conserve.** In partnership with KREM television, a half-hour television
15 program is annually developed that covers low-cost and no-cost ways to save energy
16 at home. The goal of the program is to help limited income seniors and other
17 vulnerable populations with their energy bills by providing home energy conservation
18 education. The program provides helpful energy conservation tips, information on
19 community resources and ways for customers to manage their energy bills. A DVD
20 of the program has also been produced which is included as part of energy
21 conservation kits provided in senior conservation workshops.
22
- 23 9. **Senior Energy Workshops.** Energy efficiency workshops that focus on comfort and
24 safety as well as the wise use of energy have been specially designed for the senior
25 population. Kits are provided that contain energy-saving items such as compact
26 fluorescent light bulbs, draft stoppers, rope caulking, etc. The Power to Conserve
27 program DVD along with energy efficiency tip sheets are also included in the kit.
28 Workshops are held at senior meal sites, senior centers and other senior support
29 locations.
30
- 31 10. **KHQ.com – Caregivers Resource.** Avista sponsors the Caregivers Resource page
32 on KHQ's Senior Life website in order to reach seniors and caregivers with a wide
33 variety of resource information including energy efficiency, energy assistance
34 information, Avista CARES, bill paying assistance, etc. Several video clips offer
35 low-cost, no-cost energy saving ideas.
36
- 37 11. **Senior Publications.** Avista created a one page advertisement that is placed in
38 several senior directories and publications as part of an effort to reach seniors with
39 information about energy efficiency, Comfort Level Billing, Avista CARES, and
40 energy assistance information.
41

42 Again, Mr. Kopczynski provides additional detail in his testimony concerning these and

43 other programs designed to assist customers.

1 As discussed in Mr. Folsom's testimony, the Company proposes to increase its low-
2 income weatherization funding for electric and natural gas service by a percentage amount equal
3 to the percentage rate increase granted in this case for residential customers (net of the ERM
4 surcharge reduction for electric service). The additional funding would be provided through the
5 DSM tariff rider, Schedules 91 and 191.

6 **Q. Are there other programs in the State of Washington that are available to**
7 **provide assistance to customers that need help with their energy bill?**

8 A. Yes. On September 30, 2008, President Bush signed legislation that provides
9 \$5.1 billion for the Low Income Home Energy Assistance Program (LIHEAP) for the 2008/2009
10 heating season. This increased funding will serve an additional two million households and raise
11 the average grant from \$355 to \$550, and also allows states to carryover any funds remaining to
12 next year's heating season. Washington's share of the LIHEAP funding was increased from
13 \$40,450,000 to \$74,603,000. This bill also provides increased funding for weatherization
14 assistance programs.

15 **Q. Is Avista communicating with its customers to explain what is driving the**
16 **increase in costs?**

17 A. Yes. The Company proactively communicates with its customers in a number of
18 ways: electronic customer communications, one-on-one customer interactions through field
19 personnel and account representatives, proactive and reactive media contacts, and through our
20 employees' involvement in community, business and civic organizations, to name a few. We
21 believe our communications are helping our customers, and the communities that we serve,
22 better understand the issues faced by the Company, such as increased environmental mitigation,

1 infrastructure investment, and generation constraints, all of which have led to higher costs for
2 our customers.

3 We have made extensive efforts to communicate with our customers concerning the cost
4 challenges that we are facing, and we believe these communications are helping customers better
5 understand the factors that are causing increased costs for Avista, and the utility industry in
6 general.

7 **Q. Would you please comment on the employees' dedication to achieve**
8 **customer satisfaction?**

9 A. Yes, I am pleased with the dedication of Avista Utilities' employees and their
10 commitment to provide quality service to our customers. While we continue to maintain tight
11 controls on capital and O&M budgets, our customer service surveys indicate that customer
12 satisfaction remains high. Our recent fourth quarter 2008 customer survey results show an
13 overall customer satisfaction rating of 93% in our Washington, Idaho, and Oregon operating
14 divisions. This rating reflects a positive experience for the majority of customers who have
15 contacted Avista related to the customer service they received. These results can be achieved
16 only with very committed and competent employees.

17

18

V. OVERVIEW OF AVISTA

19 **Q. Please describe Avista's current business focus for the utility and subsidiary**
20 **operations.**

21 A. Our strategy continues to focus on our energy and utility-related businesses, with
22 our primary emphasis on the electric and natural gas utility business. There are four distinct

1 components to our business focus for the utility, which we have referred to as the four legs of a
2 stool, with each leg representing customers, employees, the communities we serve, and our
3 financial investors. For the stool to be level, each of these legs must be in balance by having the
4 proper emphasis. This means we must maintain a strong utility business by delivering efficient,
5 reliable and high quality service, at a reasonable price, to our customers and the communities we
6 serve, and provide the opportunity for sustained employment for our employees, while providing
7 an attractive return to our investors.

8 The Company recently received upgrades to its corporate credit ratings to investment grade
9 by Moody's Investors Service in December 2007 and Standard & Poor's in February 2008.
10 Although we are continuing to make progress in improving the Company's financial condition, we
11 are still not as strong financially as we need to be. The Company continues to be below
12 investment grade with Fitch Ratings. Timely rate relief through this filing is an important element
13 in continuing to gain financial strength and improving our credit rating. With higher levels of
14 capital spending required over the next several years (i.e., approximately \$420 million during
15 2009-2010), it is more important than ever that the Company remain financially healthy in order to
16 attract capital investment and financing at the lowest cost possible. Company witness Mr. Thies
17 will discuss further actions taken by the Company to improve cash flow, reduce debt, and our
18 continuing efforts to improve our financial condition.

19 **Q. Please briefly describe Avista's subsidiary businesses.**

20 A. Avista Corp.'s primary subsidiary is the information and technology business,
21 Advantage IQ, described below, which is headquartered in Spokane, Washington. In 2007, Avista
22 completed the sale of the operations of Avista Energy to Coral Energy Holding, L.P., and certain

1 of its subsidiaries, a subsidiary of Shell. Avista currently holds a 6.8% share in Avista Labs'
2 successor company, ReliOn, which is held under Avista Capital. A diagram of Avista's corporate
3 structure is provided on page 1 of Exhibit No. ____ (SLM-2).

4 **Q. Please provide an overview of Advantage IQ.**

5 A. Advantage IQ, formerly known as Avista Advantage, commenced operations in
6 1998 and is a provider of utility bill processing, payment and information services to multi-site
7 customers. Advantage IQ analyzes and presents consolidated bills on-line, and pays utility and
8 other facility-related expenses for multi-site customers throughout North America. Customers
9 include, CSK Auto, Jack in the Box, Staples, and Big Lots, to name a few. Information gathered
10 from invoices, providers and other customer-specific data allows Advantage IQ to provide its
11 customers with in-depth analytical support, real-time reporting and consulting services with regard
12 to facility-related energy, waste, repair and maintenance, and telecom expenses. In 2007,
13 Advantage IQ was awarded the ENERGY STAR[®] Sustained Excellence Award in recognition of
14 its continued leadership in protecting our environment through energy efficiency.

15 **Q. What is the status of the formation of a holding company?**

16 A. In February 2006, Avista filed for regulatory approval of the proposed formation of
17 a holding company (reorganization) with the Federal Energy Regulatory Commission (FERC) and
18 the public utility commissions in Washington, Idaho, Oregon and Montana, conditioned on
19 approval by shareholders. On April 18, 2006, FERC issued its "Order Authorizing Disposition of
20 Jurisdictional Facilities" in Docket No. EC06-85-000, approving the Company's reorganization.
21 Shareholder approval of the reorganization was granted at Avista Corp.'s Annual Shareholder
22 meeting May 11, 2006. On June 30, 2006, the Idaho Public Utilities Commission issued an order

1 approving Avista's reorganization application, based on a settlement in that state. On February 28,
2 2007, the Washington Utilities and Transportation Commission issued an order approving
3 Avista's reorganization application, based on a settlement in that state. The Montana Commission
4 has yet to act on Avista's Reorganization application, and the procedural schedule for
5 consideration of the Company's application in Oregon has been suspended by agreement of the
6 parties to allow additional time for discussion among the parties.

7 **Q. Please briefly describe Avista Utilities.**

8 A. Avista Utilities provides electric and natural gas service within a 26,000 square
9 mile area of eastern Washington and northern Idaho. Of the Company's 354,732 electric and
10 314,244 natural gas customers (as of December 31, 2008), 233,087 and 145,664, respectively,
11 were Washington customers. The Company, headquartered in Spokane, also provides natural gas
12 distribution service in southwestern and northeastern Oregon. A map showing Avista's total
13 electric and natural gas service areas is provided on page 2 of Exhibit No. ____ (SLM-2).

14 As of December 31, 2008, Avista Utilities had total assets (electric and natural gas) of
15 approximately \$3.4 billion (on a system basis), with electric retail revenues of \$636 million
16 (system) and natural gas retail revenues of \$448 million (system). As of December 2008, the
17 Utility had 1,482 full-time employees.

18 Avista has a long history of innovation and environmental stewardship. At the turn of the
19 20th century, the Company built its first renewable hydro generation plant on the banks of the
20 Spokane River. In the 1980's, Avista developed an award-winning biomass plant (Kettle Falls)
21 that generates energy from wood-waste.

1 To the future, Avista as well as other utilities are facing new state and federal mandates
 2 for renewable energy and carbon control standards. For example, Washington’s Senate Bill 6001
 3 and Initiative 937 require certain public and private utilities to produce 15 percent of their power
 4 from new renewable resources by 2020, not including legacy hydro production, and to eliminate
 5 the option of coal-fired generation because of carbon emission limitations. Recognizing these
 6 changes, the Company dropped all new coal generation in its 2007 electric IRP, instead relying
 7 on natural gas, renewables, and energy efficiency. Today, Avista has one of the smallest carbon
 8 footprints in the U.S.

9 **VI. RATE REQUESTS**

10 **Q. Please provide an overview of Avista’s electric rate request in this filing.**

11 A. As previously discussed, in this filing Avista is proposing a net increase in electric
 12 retail rates of 8.6%. The proposal consists of an increase in electric base retail rates of \$69.8
 13 million or 16.00%, and a reduction in the current Energy Recovery Mechanism (ERM) surcharge
 14 of 7.4%. The Company’s request is based on a proposed rate of return of 8.68% with a common
 15 equity ratio of 47.51% and an 11.0% return on equity.

16 Mr. Hirschorn will provide details related to rate spread and rate design. The proposed
 17 rate spread for the net increase to each electric customer class is shown in the illustration below.

18 **Illustration No. 2:**

<u>Service Schedule</u>	Proposed <u>Increase</u>
Residential Service Schedule 1	9.2%
General Service Schedules 11 & 12	5.6%
Large General Service Schedules 21 & 22	8.6%

1	Extra Large General Service Schedule 25	9.2%
2	Pumping Service Schedules 31 & 32	8.6%
3	Street & Area Lighting Schedules 41-49	<u>8.6%</u>
4	Overall Increase	8.6%

6 **Q. What is Avista's natural gas rate request in this filing?**

7 A. With regard to natural gas, the Company is requesting an increase of \$4,918,000 or
8 2.3%. As with the electric increase, the Company's request is based on a proposed rate of return of
9 8.68% with a common equity ratio of 47.51% and an 11.0% return on equity. The proposed rate
10 spread for each natural gas customer class is shown in the illustration below.

11 **Illustration No. 3:**

12		Proposed
13		Increase
14	<u>Service Schedule</u>	
15	General Service Schedule 101	2.5%
16	Large General Service Schedule 111	2.0%
17	Extra Large General Service Schedule 121	2.0%
18	Interruptible Sales Service Schedule 131	0.9%
19	Transportation Service Schedule 146	
20	(excluding natural gas costs)	<u>6.8%</u>
21	Overall Increase	2.4%

22

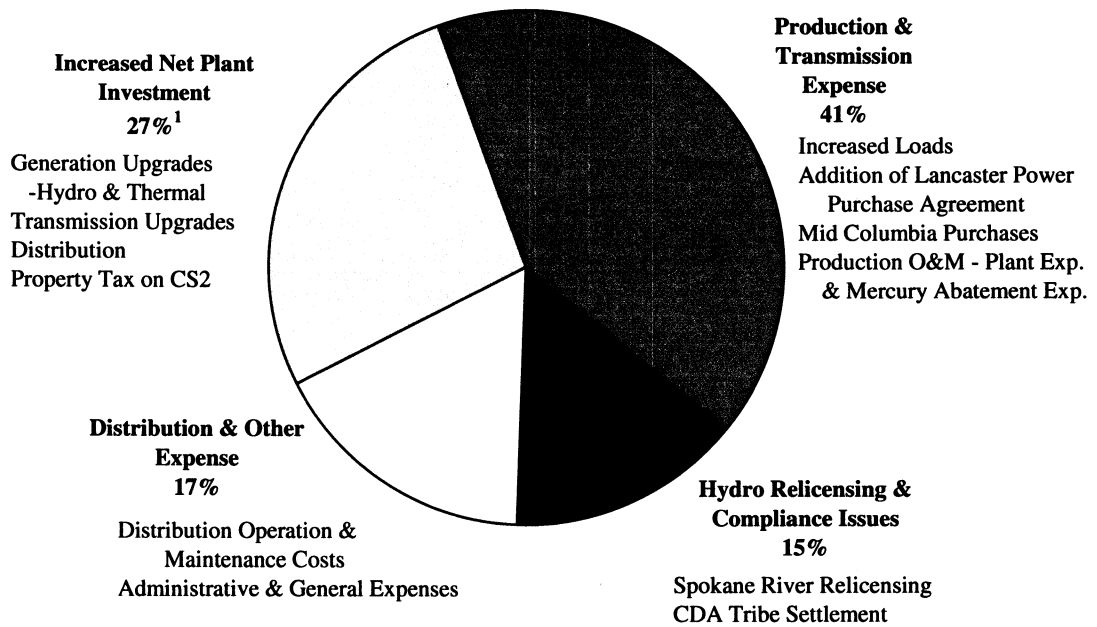
23 **Q. What are the primary factors causing the Company's request for an electric**
24 **rate increase in this filing?**

25 A. The Company's electric general rate case test period is based on 12 months ending
26 September 30, 2008, and a January 1, 2010 through December 31, 2010 proforma period. As

1 shown in Illustration No. 4, the Company’s electric request is driven primarily by hydro relicensing
 2 and compliance costs, increased capital investment to preserve and upgrade our utility
 3 infrastructure to meet growing customer demand, and higher power supply costs.

4 **Illustration No. 4:**

5 **Primary Electric Revenue Requirement Factors**



12 ¹Includes return on investment, depreciation and taxes, offset by the tax benefit of interest.

13
 14 Later witnesses provide details explaining these changes in costs.

15 **Q. What are the primary factors driving the Company’s request for a natural gas**
 16 **rate increase?**

17 **A. The Company’s natural gas request is primarily driven by changes in various**
 18 **operating cost components, mainly distribution operation and maintenance and administrative and**

1 general expenditures. This causes an increase in the fixed costs of providing gas service to
2 customers.

3 **Q. The proposed rate increase is related to changes in the fixed costs of providing**
4 **natural gas service to customers. Is the Company proposing any changes related to the cost**
5 **of natural gas in this case?**

6 A. No. Avista is not proposing changes in this filing related to the cost of natural gas
7 included in customers' current rates. Changes in natural gas costs are addressed in the annual
8 purchased gas adjustment (PGA) filings.

9

10 **VII. OTHER COMPANY WITNESSES**

11 **Q. Would you please provide a brief summary of the testimony of the other**
12 **witnesses representing Avista in this proceeding?**

13 A. Yes. The following additional witnesses are presenting direct testimony on behalf
14 of Avista:

15 Mr. Mark Thies, Senior Vice President and Chief Financial Officer will describe, among
16 other things, the overall financial condition of the Company, its current credit ratings, the
17 Company's plan for improving its financial health, its near term capital requirements, the proposed
18 capital structure, and the overall rate of return proposed by the Company. Mr. Thies explains that:

- 19
- 20 • Avista's plans call for significant capital expenditure requirements for the
21 utility over the next two years to assure reliability in serving growth in the
22 number of customers and customer demand. Capital expenditures of
23 approximately \$420 million are planned for 2009-2010 for customer
24 growth, investment in generation, transmission and distribution facilities
25 for the electric utility business as well as necessary maintenance and
replacements of our natural gas utility systems. Avista needs adequate

1 cash flow from operations to fund these requirements, together with access
2 to capital from external sources under reasonable terms.
3

- 4 • Avista’s corporate rating from Standard & Poor’s is currently BBB-.
5 Avista Utilities needs to operate at a level that will support a strong
6 investment grade corporate credit rating, meaning “BBB” or “BBB+”, in
7 order to access capital markets at reasonable rates, which will decrease
8 long-term costs to customers. Maintaining solid credit metrics and credit
9 ratings will also help support a stock price necessary to issue equity to
10 fund capital requirements.
11
- 12 • The Company has proposed an overall rate of return of 8.68%, including a
13 47.51% equity ratio and an 11.0% return on equity. We believe the 11.0%
14 provides a reasonable balance of the competing objectives of continuing to
15 improve our financial health, and the impacts that increased rates have on
16 our customers.
17

18 Dr. William E. Avera, as a President of Financial Concepts and Applications (FINCAP),
19 Inc., has been retained to present testimony with respect to the Company’s cost of common equity.

20 He concludes that:

- 21 • Application of quantitative methods to alternative groups of proxy companies imply
22 a cost of equity range of 11.3 percent to 13.3 percent.
- 23 • Because Avista’s requested ROE of 11.0% percent falls below the lower end of the
24 recommended range, it represents a conservative estimate of investors’ required rate
25 of return.
- 26 • Considering investors’ expectations for capital markets and the need to support
27 financial integrity and fund crucial capital investment even under adverse
28 circumstances, 11.0% percent is a reasonable, albeit conservative, ROE for Avista.
- 29 • Because of Avista’s reliance on hydroelectric generation, the Company is exposed
30 to relatively greater risks of power cost volatility.
- 31 • Avista’s requested capitalization is consistent with the Company’s need to
32 strengthen its credit standing and financial flexibility as it seeks to raise additional
33 capital to fund significant system investments and meet the requirements of its
34 service territory.
- 35 • The reasonableness of a minimum 11.0% percent ROE for Avista is also supported
36 by the greater risks associated with the Company’s relatively small size and the need
37 to consider flotation costs.
38

1 **Mr. Richard Storro**, Vice President of Energy Resources, will provide an overview of
2 Avista's resource planning and power operations, the Lancaster Power Purchase Agreement, hydro
3 and thermal plant upgrades, hydro relicensing, and generation plant operation and maintenance
4 issues. Mr. Storro explains:

- 5 • Avista's electric generation portfolio, including power supply operations;
- 6 • The Company is in an annual balanced-to-surplus energy position through 2017
- 7 with the addition of the Lancaster Power Purchase Agreement (PPA);
- 8 • An update on renewable energy acquisitions;
- 9 • Avista's risk management policy for energy resources, including the electric
- 10 hedging plan;
- 11 • The Company's involvement with the Chicago Climate Exchange;
- 12 • The prudence of the Lancaster PPA
- 13 • Upgrades to the Noxon Rapids Project;
- 14 • Hydro relicensing issues on the Clark Fork and Spokane Rivers; and
- 15 • Increased levels of expenditures for plant operations and maintenance.
- 16

17 **Mr. Clint Kalich**, Manager of Resource Planning & Power Supply Analyses, will describe
18 the Company's AURORA_{XMP} model (Dispatch Model) inputs, assumptions, and results related to
19 the economic dispatch of Avista's resources to serve load requirements, and market forecast of
20 electricity prices. He explains:

- 21 • The key assumptions driving the Dispatch Model's market forecast of electricity
- 22 prices. This discussion includes the variables of natural gas, Western Interconnect
- 23 loads and resources, and hydroelectric conditions.
- 24 • How the model dispatches Avista's resources and contracts in a manner that
- 25 maximizes benefits to customers.
- 26 • The use of quantitative rate-period loads for January 2010 through December 2010,
- 27 for modeling pro forma net power supply expenses.
- 28 • The output results from the model, including thermal generation and short-term
- 29 wholesale sales and purchases, were provided to Mr. Johnson to incorporate into the
- 30 power supply pro forma adjustments.
- 31

1 Mr. William Johnson, Wholesale Marketing Manager, will identify and explain the
2 proposed normalizing and pro forma adjustments to the test period power supply revenues and
3 expenses. He will also explain the new base level of power supply costs for Energy Recovery
4 Mechanism (ERM) calculation purposes using the pro forma costs proposed by the Company in
5 this filing. Mr. Johnson describes:

- 6 • The adjustment of revenues and expenses based on normal streamflow and weather
7 conditions, and expected wholesale market power prices.
- 8 • Adjustments made to reflect known and measurable changes in power contracts,
9 thermal generation fuel expense, and transmission expense, between the test period,
10 and the pro forma period.
- 11 • The net effect of the adjustments to the test period power supply expense is an
12 increase of \$57,240,000 on a system basis, \$36,971,000 Washington allocation.
- 13 • This increase in pro forma power supply expense over the expense currently in base
14 rates is based on numerous factors, primarily higher retail loads and the addition of
15 the Lancaster plant Power Purchase Agreement.

16
17 Mr. Don Kopczynski, Vice President of Transmission and Distribution Operations, will
18 describe Avista's electric and natural gas energy delivery facilities and operations, and recent
19 efforts to increase efficiency and improve customer service. Mr. Kopczynski describes:

- 20 • Avista's customer service programs such as the Low-Income Rate Assistance
21 Program (LIRAP), energy efficiency, Project Share, CARES program, Senior
22 Outreach Program, and payment plans. Some of these programs will serve to
23 mitigate the impact on customers of the proposed rate increase.
- 24 • The Company's multi-faceted effort to increase customer service automation,
25 including replacement and upgrade of the new Interactive Voice Response (IVR)
26 system, Mobile Dispatch, Outage Management System, transmission and
27 distribution system efficiencies, and Web Redesign.
- 28 • The decision by the Company to outsource our bill printing and mailing services.
29 This decision was based on Company needs for disaster recovery compliance, added
30 scalability and flexibility, and cost savings.

31
32 Mr. Scott Kinney, Director, Transmission Operations, will discuss the electric transmission
33 and distribution investments included in this case, and presents the Company's pro forma period

1 transmission revenues and expenses. In addition, he describes the Company's Asset Management
2 Program. Mr. Kinney explains:

- 3 • Avista is expecting to invest over \$15.1 million (system) in electric transmission
4 projects with completion dates in 2009.
- 5 • Several revisions have been made to transmission expenses for the 2010 pro forma
6 period.
- 7 • Changes in replacement and maintenance costs associated with the Company's asset
8 management program.
- 9

10 Mr. Dave DeFelice, Senior Business Analyst, will describe the pro forma adjustment for
11 non-revenue capital expenditures. Mr. DeFelice explains:

- 12 • The rising cost of essential materials specific to the utility industry is causing
13 significant increases in capital project funding requirements.
- 14 • These costs must be pro formed into historical test-year computations in order to
15 allow necessary recovery of our costs to serve customers.
- 16

17 Ms. Elizabeth Andrews, Manager of Revenue Requirements, will discuss the Company's
18 overall revenue requirement proposals. In addition, her testimony generally provides accounting
19 and financial data in support of the Company's need for the proposed increase in rates. She
20 sponsors:

- 21 • Electric and natural gas revenue requirement calculations.
- 22 • Electric and natural gas results of operations.
- 23 • Pro forma operating results including expense and rate base adjustments.
- 24 • System and jurisdictional allocations.
- 25

26 Ms. Tara Knox, Senior Regulatory Analyst, sponsors the cost of service studies for electric
27 and natural gas service, the revenue normalization adjustments to results of operations, and the
28 proposed retail revenue credit rate. Ms. Knox studies indicate:

- 29 • Electric residential service, extra large general service, and pumping service
30 schedules are earning less than the overall rate of return under present rates, while

1 general service, large general service and the street and area lighting service
 2 schedules are earning more than the overall rate of return under present rates.
 3 However, only general service Schedule 11 is currently providing a rate of return
 4 greater than the rate of return requested in this case.

- 5 • Natural Gas small firm and high load factor large firm service schedules are
 6 earning less than the overall rate of return at present rates, and interruptible and
 7 transportation service schedules are earning more than the overall rate of return,
 8 while residential service is right at unity. However, all customer groups are
 9 currently providing a rate of return lower than the rate of return requested in this
 10 case.

11
 12 Mr. Brian Hirschhorn, Manager of Pricing, discusses the spread of the proposed annual
 13 revenue changes among the Company's general service schedules. He explains, among other
 14 things, that:

- 15 • The proposed net increase in electric retail rates is 8.6%, which consists of an
 16 increase in electric base retail rates of \$69.8 million or 16.00%, and a reduction in
 17 the current ERM Surcharge of \$32.3 million or 7.4%.
- 18 • The monthly bill for a residential customer using an average of 1,000 kWhs per
 19 month would increase from \$75.94 to \$82.93 per month, an increase of \$6.99 or
 20 9.2%. This includes the proposed increase in the monthly basic or customer charge
 21 from \$5.75 to \$6.00.
- 22 • The Company is requesting that the reduction in the ERM Surcharge become
 23 effective coincident with the effective date of new retail rates.
- 24 • The proposed natural gas annual revenue increase is \$4.9 million, or 2.3%.
- 25 • The monthly bill for a residential customer using 70 therms per month would
 26 increase from \$85.40 to \$87.51 per month, an increase of \$2.11 or 2.5%. This
 27 includes the proposed increase in the monthly basic or customer charge from \$5.75
 28 to \$6.00.

29
 30
 31 Mr. Bruce Folsom, Senior Manager of Demand Side Management, provides an overview of
 32 the Company's DSM programs and documents Avista's expenditures for electric and natural gas
 33 energy efficiency programs. Mr. Folsom explains that:

- 34 • The Company exceeded its 2008 electric efficiency targets by approximately 40%
 35 and 2008 natural gas efficiency target by approximately 34%.
- 36 • Avista's expenditures for electric and natural gas energy efficiency programs from
 37 January 1, 2008 through November 30, 2008 have been prudently incurred.

1

2

Q. Does this conclude your pre-filed direct testimony?

3

A. Yes.