

APPENDIX 3

**Avista Dockets UE-050482 and UE-050483:
Excerpt from Exhibit 1,
Testimony of Hank McIntosh, et al.
For Commission Staff, et al.
(Cover page and pages 1, and 21-25)**

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION d/b/a
AVISTA UTILITIES

Respondent.

DOCKET NOS. UE-050482
UG-050483

STATE OF WASH.
UTIL. AND TRANSP.
COMMISSION

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JOINT DIRECT TESTIMONY OF

KELLY NORWOOD (AVISTA)
BRIAN J. HIRSCHKORN (AVISTA)
ROGER BRADEN (STAFF)
MICHAEL PARVINEN (STAFF)
HANK McINTOSH (STAFF)
JOELLE STEWARD (STAFF)
DONALD W. SCHOENBECK (NWIGU)
CHARLES EBERDT (ENERGY PROJECT)

IN SUPPORT OF
THE SETTLEMENT AGREEMENT

WUTC		
DOCKET NO. <u>UE-050482</u>		
EXHIBIT # <u>1</u>		
ADMIT <input checked="" type="checkbox"/>	W/D <input type="checkbox"/>	REJECT <input type="checkbox"/>

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I. INTRODUCTION

Q. Please state your names, titles, and who you represent in this matter?

A. Our names, titles, and representation are as follows:

- Kelly O. Norwood, Vice-President of State and Federal Regulation, Avista
- Brian Hirschorn, Manager-Pricing, Avista
- Roger Braden, Assistant Director for Energy, WUTC Staff
- Mike Parvinen, Regulatory Analyst, WUTC Staff
- Hank McIntosh, Regulatory Analyst, WUTC Staff
- Joelle Steward, Regulatory Analyst, WUTC Staff
- Donald W. Schoenbeck, Regulatory & Cogeneration Services, Inc.,
Consultant, NWIGU
- Charles M. Eberdt, Program Manager, The Energy Project

Q. Are you sponsoring joint testimony in support of the Settlement Agreement filed with this Commission on August 12, 2005?

A. Yes. This joint testimony recommends approval of the Settlement Agreement by the Commission. The Settlement Agreement represents a compromise among differing points of view. Concessions were made by all Signing Parties to reach a reasonable balancing of interests. As will be explained in the following testimony, the Settlement Agreement received significant scrutiny and is supported by sound analysis and sufficient evidence. Its approval is in the public interest. The Settlement Agreement has been marked as Exhibit ____.

Q. Have you provided information pertaining to your educational background and professional experience?

A. Yes. Exhibit ____ contains a summary of our qualifications.

1 **Q. Did Staff also review Avista's acquisition in 2005 of the second half of**
2 **the Coyote Springs 2 ("CS2") combined cycle natural gas turbine generator for the**
3 **purpose of forming an opinion as to the prudence of that acquisition?**

4 A. Yes.

5 **Q. What data and other information did Staff review in its analysis of the**
6 **CS2 acquisition?**

7 A. Staff reviewed the prefiled testimony and exhibits of Avista witness Mr.
8 Ronald R. Petersen (Exhibit __ (RRP-1T), as well as Avista responses to data requests
9 submitted by Staff.

10 **Q. In general terms, what criteria did Staff consider in order to determine**
11 **whether the CS2 acquisition was prudent?**

12 A. Staff considered whether, in light of all relevant factors, Avista's decision to
13 acquire the second half of CS2 was based upon appropriate, rational and reasoned methods,
14 utilized appropriate data, and covered specific issues that the Commission identified for
15 consideration in the 19th Supplemental Order in Docket Nos. UE-920433, UE-920499,
16 UE-921262, which includes dispatchability and fuel price risk. This Order suggests
17 methods and processes of decision-making are important elements of a prudence review.
18 Further, Avista's most recent IRP (April 2003) identified a Preferred Resource Strategy
19 (Resource Strategy) including a mix of wind, coal, conservation, and natural gas-fired
20 resources. The natural gas-fired combined-cycle component of the 2003 IRP Resource
21 Strategy equaled 149 MW. The opportunity to acquire the remaining half of CS2, at 140
22 MW, is consistent with the 2003 IRP long-term Resource Strategy. Staff considered all of
23 these factors in its review of the prudence of the CS2 acquisition.

1 In general terms, Staff applied a "reasonableness" standard in applying the above
2 referenced factors to assess prudence. This is consistent with prior Commission decisions,
3 as evidenced by the following quotations:

4 "In evaluating prudence it is generally conceded that one cannot use the advantage
5 of hindsight. The test this Commission applies to measure prudence is what would
6 a reasonable board of directors and Puget management have decided given what
7 they knew or reasonably should have known to be true at the time they made a
8 decision. This test applies both to the question of need and the appropriateness of
9 the expenditures." WUTC v. Puget Sound Power and Light Co., 1984 Cause No.
10 U-85-54 1st Supplemental Order pp. 32 to 33.

11
12 "The Commission relies upon a reasonableness standard. The company must
13 establish that it adequately studied the question of whether to purchase these
14 resources and made a reasonable decision, using the data and methods that a
15 reasonable management would have used at the time the decisions were made."
16 WUTC v. Puget Sound Power & Light Co., at page 17, UE-921262, et al. (Sept.
17 27, 1994) (citing Second Supplemental Order, Cause No. U-85-53 (May 16, 1986)
18 and Fifth Supplemental Order, Docket No. U-83-26 (Jan. 19, 1984)).

19
20 **Q. Does Staff believe that the acquisition of a least cost resource**
21 **necessarily resulted in a prudent decision?**

22 A. No. Cost is not the sole measure of prudence. It is, however, an important
23 factor to consider. In this instance there is no doubt that, given the knowledge available to
24 the Company at the time of the acquisition of CS2, the price paid by the Company was low.
25 Avista's comparative price analysis is discussed below.

26 **Q. What analytical methods did Avista use in reaching its decision to**
27 **acquire the second half of CS2?**

28 A. The most important methodological feature was the use of the Aurora
29 market model for valuation. This tool allowed hourly dispatch modeling of CS2. The
30 second most important tool was the use of an independent consultant to review their work
31 and to do an independent analysis using another market model and their capacity market

1 survey. The third most important tool was the use of scenarios of electric and gas prices to
2 test the value of CS2 under a range of possible price conditions.

3 **Q. Did Avista consider location with respect to their control area and**
4 **transmission constraints?**

5 A. Yes.

6 **Q. Did Avista consider that fuel prices may vary over the life of the**
7 **facility?**

8 A. Yes.

9 **Q. Did Staff find any evidence of systematic bias in favor of or against a**
10 **particular choice of technology or strategy?**

11 A. No.

12 **Q. Were risks considered by Avista?**

13 A. Yes. The risk associated with gas fuel market price and electric market
14 price was modeled. Indirectly, the effect of hydrological conditions was modeled by using
15 market demand under average hydro conditions. These elements of risk to the cost of
16 power supply are the major considerations of operational risk. Carbon tax scenarios were
17 also considered as an ownership risk. The risk of increasing reliance on a single generator
18 shaft was also evaluated.

19 **Q. Did Staff consider the impact of natural gas prices in its evaluation of**
20 **CS2?**

21 A. Staff noted that CS2 is fueled by contracts with TransCanada Gas
22 Transmission Northwest for transmission on a mileage based rate and suppliers in AECO-
23 C but did not include any review of the future gas fuel cost since there is no specific

1 commodity contract in place. Like many gas turbines, CS2 is fueled by commodity deals
2 which include month ahead, year ahead and other products. In the current climate of energy
3 markets, this is not surprising. The fuel price estimate used in the production cost model,
4 Aurora, is estimated on a three-month rolling average of NYMEX strips, which after
5 adjusting for basin differentials, are used as a predictor of spot gas prices in Sumas, AECO,
6 Rockies and San Juan gas markets. This method was recommended in the final
7 Commission Order in a recent electric general rate case for PSE, Docket No. UG-
8 040640/UE-040641 and is acceptable to Staff for this case.

9 **Q. Did Staff analyze the cost of purchasing the second half of CS2?**

10 A. Yes. Staff compared CS2's average \$/kW cost to the averages in Mr.
11 Peterson's testimony and other known sources. For the 2003-2004 time period, Mr.
12 Peterson testified that the average cost of comparable resources ranged from \$558/kW to
13 \$670/kW. Staff examined the work of Avista's consultant, Navigant, and found their
14 market value analysis convincing. Their estimate was \$472/kW and Avista's internal
15 estimate was \$468/kW. Staff concluded that CS2's cost of \$439 /kW is reasonable.

16 **Q. Did Staff reach an overall conclusion about Avista's acquisition of the**
17 **second half of CS2 was prudent?**

18 A. Yes. Based on all of the factors and analysis described above, Staff is of the
19 opinion that Avista's acquisition of the second half of CS2 was prudent.

20 **Q. Is the financial impact of CS2 included in the parties' Settlement?**

21 A. Yes. It is included in Avista's rate base and the costs and benefits of CS2
22 operations are included in the power cost results incorporated into the Settlement.

1 **Q. If the Commission decides to accept the Settlement do the Signing**
2 **Parties request a prudence determination from the Commission on the Company's**
3 **acquisition of the second half of CS2?**

4 A. Yes. The Signing Parties request that the Commission specifically find, in
5 any order adopting the Settlement Agreement, that CS2 was prudently acquired.

6
7 **VI. MODIFICATIONS TO THE ENERGY RECOVERY MECHANISM (ERM)**

8 **Q. Are any modifications being proposed to the Company's existing**
9 **Energy Recovery Mechanism, or ERM?**

10 A. Yes. Certain modifications to the existing Energy Recovery Mechanism
11 will be implemented as follows.

- 12 • Deadband – The \$9 million deadband will be reduced to \$3 million, effective
13 December 1, 2005.
- 14 • For calendar year 2005, the level of the deadband would be prorated to coincide with
15 an assumed December 1, 2005 effective date of the Settlement. There will be no
16 change in the 90%/10% sharing or any other aspect of the mechanism.
- 17 • For January 1 through November 30, 2005, the existing \$9 million deadband would
18 apply; thereafter, from December 1 through December 31, 2005, the agreed-upon \$3
19 million deadband would apply, with the result that the effective deadband, as prorated,
20 for calendar year 2005 would be \$8.5 million. Thereafter, until further modified, a \$3
21 million deadband would apply.