BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-010395

DIRECT TESTIMONY OF DON M. FALKNER
REPRESENTING THE AVISTA CORPORATION

Exhibit T-___(DMF-T)

Q. Please state your name, business address, and present position with Avista Corp.

A. My name is Don M. Falkner. My business address is East 1411 Mission Avenue, Spokane, Washington. I am employed by Avista Corp. (Company) as a Senior Rate Analyst.

Q. Would you please describe your education and business experience?

A. I graduated from Washington State University in February of 1981 with a Bachelor of Arts Degree in Business Administration majoring in Accounting. That same year, I passed the May Certified Public Accountant exam and joined The Company in June. I have served in various positions within the sections of the Finance Department, including Power Supply Accounting, Subsidiary Accounting, Budget and Forecasting, Plant Accounting and Corporate Accounting. For the past 9 years, I have served in the Rates and Tariff Administration Section, which is part of the Company's External Relations Department.

Q. As a Senior Rate Analyst, what are your responsibilities?

A. As a Senior Rate Analyst, aside from special projects, I am responsible for preparation of normalized semi-annual Commission Basis reporting in the various jurisdictions in which the Company provides utility services. I also have been the lead revenue requirements witness in the Company's most recent general rate filings.

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

A. I will be presenting the Company's calculation of the overall revenue requirement and will also include an explanation of how an existing balance sheet credit, known as the "PGE" credit, is proposed to be used by the Company to reduce the magnitude of the surcharge increase to its customers.

Q. Are you sponsoring any exhibits to be introduced in this proceeding?

A. Yes. I am sponsoring Exhibit No.___(DMF-1), which was prepared under my supervision and direction.

REVENUE REQUIREMENT

Q. Please explain the development of the overall increase?

A. In developing the surcharge of 36.9%, the Company attempted to achieve a balance of mitigating the overall impact to customers, while also reducing the surcharge balance to zero as quickly as possible to address the concerns of the financial community. The starting point for the calculation is the actual deferral balance at June 30, 2001. Projected deferral entries beyond June 30, 2001 and through December 2003 are then added to the actual balance.

That calculation shows that absent a recovery plan, the deferral balance for our Washington jurisdiction would grow to approximately $200 million by the end of 2001 and be slightly over $250 million by the end of 2003. The derivation of the deferral entries is explained in more detail by Mr. Norwood. The Company is proposing to amortize a deferred credit on the Company's balance sheet related to the monetization of the Portland General Electric (PGE) Sale Agreement as an offset to the power cost deferral balance to reduce the overall rate impact to customers. The Company is then proposing that the remaining balance of the deferred costs be recovered by the end of 2003 through the surcharge. This is illustrated by the chart on page 2 of Exhibit No. ____ (DMF-1).

Q. Why was the end of December 2003 chosen as the end of the amortization and recovery period?

A. December 2003 was chosen in an effort to balance a number of competing considerations including the size of the surcharge, the duration of recovery of the deferral balance, the need to immediately improve the financial health of the Company, as well as taking into consideration the timing of the need for additional power resources. A surcharge period shorter than December 2003 would improve the financial health of the Company sooner, but would result in a significantly higher surcharge rate increase. A surcharge period beyond December 2003 would extend into a period when the Company shows a need for new firm energy resources and would not lead to needed financial improvement soon enough. The Company's existing 200 MW purchase from TransAlta expires in December 2003, and Avista will need additional firm energy resources beginning in 2004. The costs associated with these new resources may cause an increase in retail rates, therefore, the Company is proposing a surcharge period that ends prior to 2004.

Q. Is the Company proposing to be allowed to recover a level of projected power cost differences, or differences in costs that have not been recorded or incurred yet, in the proposed surcharge?

A. No. Projections were utilized in the initial determination of the surcharge, level. However, only actual cost differences will be recovered; the proposed surcharge rates will be adjusted based on the actual cost differences. The Company has added the following language under the proposed Power Cost Surcharge Schedule 93 to insure clarity on this issue: "The rates set forth under this Schedule are subject to periodic review and adjustment by the WUTC based on the actual balance of deferred power costs."

Q. The Company is proposing that the deferral balance be recovered over a 27 month period. How was the annual revenue requirement determined?

A. The actual calculation is reasonably straight-forward. The starting point is the beginning deferral balance at June 30, 2000. Additional deferrals as outlined by Mr. Norwood were added, as well as the benefits of the "PGE" credit which will be described below. The annual amount was determined through an iterative process that produced the annual revenue level necessary to reduce the deferral balance to approximately zero by December 31, 2003.

Q. Did that revenue level need to be adjusted to determine a final revenue requirement?

A. Yes. The annualized surcharge revenue level necessary to reduce the deferral balance to zero by December 31, 2003 was $80,409,105. That figure is the starting point for the final revenue requirement calculation, as can be seen on page 1 of Exhibit No.___ (DMF-1). The $80,409,105 amount must then be adjusted for revenue sensitive expenses such as Commission Fees, Franchise Fees and Uncollectible Expense. Additionally, equity return deferrals associated with the Company's small generation projects, plus the Coyote Springs II Project, required an income tax gross up. The conversion factors used were the same calculations authorized in the Company's most recent general case (UE-991606) updated for actuals through December 31, 2000, and as filed with the Commission. The resulting revenue requirement is $87,387,337 for an overall surcharge increase of 36.9%. This calculation is illustrated on page 1 of Exhibit No. ___ (DMF-1).

Q. What would the proposed surcharge be if the Company requested to recover only actual deferred costs over a 12-month period?

A. Based on recovery of the actual balance of deferred costs at the end of June 2001 ($109 million) over a 12-month period, the result would have been a rate increase of 46%, as compared to the proposed increase of 36.9%.

Q. Is the Company requesting that the deferred accounting mechanism currently in effect be continued at least through the proposed recovery period, ending December 31, 2003.

A. Yes. As can be seen on the chart on page 2 of my Exhibit No.___(DMF-1), the mechanism and the surcharge need to both continue through December 31, 2003 to decrease the deferral balance to zero and to continue the balancing account nature of the deferral accounting mechanism.

Q. What is the Company's rate plan in regards to dealing with prudence of the surcharge level and other power supply related filings currently required by the Commission?

A. Avista would file a general rate case during November 2001. That filing would address, among other things, the prudence of the deferred power costs, the regulatory treatment of the Coyote Springs II project that is scheduled for commercial operation in June 2002, a long-term periodic power cost adjustment mechanism, and the power supply related issues that the Commission ordered Avista to address in its Third Supplemental Order, dated September 29, 2000, in Docket No. UE-991606.

The Company is proposing that the surcharge remain in place until December 31, 2003. At the conclusion of the general rate case, the Company would modify the surcharge amount and the duration of the surcharge rate, if needed, in order to reflect the outcome of the general rate case.

PGE CREDIT

Q. Please explain the Company's utilization of the "PGE" Credit in the determination of the surcharge increase?

A. In the Company's last general case this Commission determined the disposition of what they called "PGE Contract Test Year Buydown Funds." PGE is the acronym for Portland General Electric. Essentially, the funds were the result of a monetization of a long-term capacity contract with PGE. The Company is currently amortizing a portion of the PGE monetization credit balance over a multi-year period, as well as reflecting appropriate rate base reductions, per the Commission's Third Supplemental Order, dated September 29, 2000, in Docket No. UE-991606. Page 123 of that Order provides the details of that decision. Another portion of the PGE credit is not being amortized. However, the Fourth Supplemental Order granting reconsideration in Docket No. UE-991606, paragraph 57, notes that the Company may petition for amortization of that portion of the credit.

Q. What is the Company proposing in regards to the PGE credit in this proceeding?

A. The Company is proposing to accelerate the amortization of the PGE credit balance that is currently being amortized and to start amortization of the balance that is not being amortized, beginning in October 2001, and apply the increased amortization against the deferred power cost balance. This amortization works to reduce the amount of deferred power costs that must be collected from customers through the surcharge. The Company is proposing that the amortization be increased to a level that would cause the PGE credit balance remaining on Avista's balance sheet at October 1, 2001 to be fully amortized by December 31, 2002. This is one year earlier than the targeted date of December 31, 2003 to eliminate the power cost deferral balance. By using the PGE credits at a faster rate than the December 31, 2003 date, the overall surcharge to customers is decreased. The accelerated amortization of the PGE balance would not improve the Company's cash flow, since these entries would be non-cash accounting entries, but would mitigate the overall impact to customers from the power cost deferrals. The accelerated amortization of the PGE balance would reduce the deferred power cost balance by $53.8 million by December 31, 2002.

Q. Would this accelerated amortization eliminate all of the PGE credit for Washington customer at December 31, 2002?

A. No. A regulatory adjustment would continue to be made for approximately another 7 years associated with the interest component that was part of the Commission's Third Supplemental Order.

Q. Please explain?

A. The Order included a certain recognition of the time value of money on the lump sum monetiztion payment received by the Company from December 31, 1998 through October 1, 2000. This amount was determined to be $14,205,414 and the Order included this amount in the balance of funds at October 1, 2000 available to accomplish certain rate base offsets. The interest component is a regulatory adjustment and is not reflected on the Company's balance sheet. The $54 million of PGE credit that is utilized in the calculation of the surcharge amount is the amount remaining unamortized on the Company's balance sheet at October 1, 2001.

Q. How would the Company account for this accelerated amortization of the PGE credit?

A. The proposed accounting entries related to the accelerated amortization of the PGE balance would be to debit the PGE deferred revenue account and to credit the power cost deferral account, thereby reducing the power cost deferral balance to be recovered through the cash surcharge to customers.

Q. The Company's current proposal is for a 36.9% increase. What would the overall increase to customers have been if the PGE credit had not been used to mitigate the increase?

A. The overall increase to customers would have been approximately 48%.

Q. Does that conclude your direct testimony?

A. Yes, it does.

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EXHIBIT NO. ____ (DMF-1)

WITNESS: DON M. FALKNER, AVISTA CORP.

AVISTA CORP.
SURCHARGE REVENUE REQUIREMENT CALCULATION
WASHINGTON JURISDICTION

Line No.			WA
1	a	Annual State Surcharges Amounts before Conversion Factor Analysis	$80,409,105
		GROSS UP CALCULATION FOR EQUITY RETURN INCLUDED IN DEFERRAL	
2		Total Equity Deferrals for Owned Capital Projects	$13,193,399
3		Recovery Period in Months	27
4		Monthly Net of Tax Recovery	488,644
5		Annualized Net of Tax Recovery	5,863,733
6		Conversion Factor per 12/2000 CBR Reports	0.62158
7		Annualized Gross Revenue Req	9,433,593
8	b	Incremental Revenue for Equity Return Deferral Surcharge Gross Up	3,569,860
		GROSS UP CALCULATION FOR MISC REVENUE RELATED EXPENSES	
9		Annual State Surcharges before Conversion	80,409,105
10		Annualized Equity Return Recovery Component	5,863,733
11		Annual State Surcharges Net of Equity Return Recovery	74,545,372
12		Revenue Related Expense Conversion Factor per 12/2000 CBR Reports	0.956277
13		Annualized Gross Revenue Req for non-Equity Deferral Surcharge	77,953,744
14	c	Incremental Revenue for non-Equity Return Deferral Surcharge Gross Up	3,408,372
15	d	Total Surcharge Revenue Requirements d = a + b + c	$87,387,337
16		Normalized General Business Revenues	$236,966,000
		Overall General Business Percentage Increase	36.9%

AVISTA UTILITIES

Projected Washington Electric Deferral Balances

Based on July 3 Forward Prices

Utilizing Surcharge of 36.9% (10/01 - 12/03) and 15 Month PGE Amortization