REVISED Page 31, May 25, 2012

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-12\_\_\_\_\_\_\_

DOCKET NO. UG-12\_\_\_\_\_\_\_

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 please 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, a member of ReliOn board of directors, and board director of the Washington Roundtable. On January 1, 2011, I was appointed to the Federal Reserve Bank of San Francisco, Seattle Branch board of directors and in January 2012 I was appointed as Chairman of the Board to Innovate Washington by Governor Christine Gregoire. I also serve on the board of trustees of Greater Spokane Incorporated.

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

A. I will first explain why Avista is requesting another rate increase through this filing, and summarize the Company’s electric and natural gas rate requests. A large part of our need for a rate increase is driven by the costs associated with continuing to expand and replace the facilities we use every day to serve our customers. When we remove the old equipment and replace it with new, it results in higher overall costs to serve customers. This was the primary reason for the proposed increase in our last rate increase request and it is expected to continue to cause a need for increased rates in the future. In addition, in recent years we have been consistently earning well below the rate of return approved by the Washington Utilities and Transportation Commission (UTC or Commission), therefore, part of our rate request reflects additional revenue to give us the opportunity to actually earn the return approved by the Commission.

I will also discuss some of the measures we have taken to cut costs, as well as initiatives to increase operating efficiencies in an effort to mitigate future cost increases to customers. I will briefly explain the Company's customer-support programs in place to assist our customers, as well as our communications initiatives to help customers better understand the changes in costs that are causing our rates to increase. Finally, I will introduce each of the other witnesses providing testimony on the Company’s behalf.

A table of contents for my testimony is as follows:

Description Page

I. Introduction 1

II. Why Avista Is Requesting Another Rate Increase 4

III. Summary of Rate Requests 15

IV. Cost Management and Efficiencies 21

V. Communications with Customers 23

VI. Customer Satisfaction 27

VII. Customer Support Programs 27

VIII. Other Company Witnesses 29

**Q. Are you sponsoring exhibits in this proceeding?**

A. Yes. I am sponsoring two exhibits. Exhibit No. \_\_\_\_\_ (SLM-2) includes an overview of Avista and its utility and subsidiary operations, as well as a diagram of Avista’s corporate structure. Exhibit No. \_\_\_\_\_ (SLM-3) includes a map showing Avista’s electric and natural gas service areas.

**Q. What are the rate increases requested by Avista in this filing?**

A. Avista is requesting an overall net electric billed rate increase of 5.9% which is comprised of a billed rate increase of 8.8% requested in this case and a proposed one-year Energy Recovery Mechanism (ERM) bill decrease (rebate to customers) of 2.9%. The proposed natural gas billed rate increase is 6.8%.[[1]](#footnote-1)

##### II. WHY AVISTA IS REQUESTING ANOTHER RATE INCREASE

**Q. Why is Avista requesting another rate increase following the recent increase that was approved, effective January 1, 2012?**

A. Before I address our rate request, I would like to specifically address the issue of the economy. The people of the State of Washington and our Country are continuing to face the challenges of a difficult economy. In our 2011 general rate case proceeding, the Commission received a number of comments from customers related to our proposed rate increase. The comments addressed, among other things, the state of the economy, the need for Avista to “tighten its belt,” concerns about executive compensation, and an inability to pay energy bills by seniors and those on limited incomes. We have read every one of the written comments, and I have read many of them myself, and I can assure you that the decisions we make at Avista are not made without taking into consideration the current state of the economy, as well as the other issues raised by our customers.

With regard to our low income customers, our analysis shows that our programs to assist low income customers with their energy bills are more extensive than any other investor-owned electric or natural gas utility in the state of Washington, and for that matter, in Idaho and Oregon as well. With regard to cost-control, as I will explain later, we contracted with a consultant two years ago to come in to Avista to take an independent, objective look at opportunities to do our work more efficiently and more cost-effectively. Although some areas were identified where efficiencies could be gained, we also found that many of our operations were already efficient and cost-effective.

In the past several years we have also made substantial cuts in our capital budget in order to mitigate rate impacts to customers. Because we have chosen to not spend millions of dollars on facilities that need to be replaced, this has also contributed to higher unemployment in the State.

At the same time, while we continue to maintain tight controls on capital and O&M budgets, our customer service surveys indicate that customer satisfaction remains high. Our overall customer satisfaction from our voice-of-the-customer surveys in the fourth quarter of 2011 was 95% in our Washington, Idaho, and Oregon operating divisions. This rating reflects a positive experience for customers who have contacted Avista related to the customer or field service they received.

I believe that many of our customers, however, do not understand that there are limitations on how far we, as a utility, can go with cost-cutting before we begin to jeopardize reliability of service and customer satisfaction. As a regulated company Avista has an obligation to safely and reliably serve every customer that requests service.

**Q. How does that obligation to serve limit the ability of Avista to cut spending?**

A. Avista has a legal obligation to provide safe and reliable service to every customer that requests electric or natural gas service from the Company. When a new customer requests service, we must hook them up, even if the cost to serve that customer results in increased costs to all other customers. Likewise, if the facilities serving an existing customer are deteriorating and need repair, we must repair or replace them so that the customer continues to receive safe, reliable service.

We have highlighted some of these points in prior filings, but they bear repeating because they get to the heart of why we are requesting a rate increase in the midst of a continuing difficult economy.

We have heard the comments from some of our customers to the effect that Avista should cut its costs, and “tighten its belt” like other businesses are having to do in these difficult economic circumstances. And we have taken steps to do so. But at the same time we are not like other businesses. Without the obligation to serve, we could consider refusing to hook up new customers, because it could avoid an increase in costs to our existing customers. Without an obligation to serve, we could consider no longer serving some of the more remote, more costly areas to provide service, which would allow us to avoid further investment, and reduce labor and other operating costs. Unregulated businesses have the opportunity to shut down aging facilities or under-producing retail outlets, eliminate product lines, and cut back on investment and maintenance. We do not.

We do have opportunities to cut back on investment and operating costs, and we have where prudent to do so. But those opportunities are limited by our obligation to safely and reliably serve all customers, and our obligation to comply with numerous mandatory state and federal requirements. We simply don’t have the choice to say no to new customers, no to maintaining a safe, reliable system, and no to mandatory requirements. Although we have taken measures to ensure that the costs that we incur represent the most cost-effective and reliable way to continue to serve our customers, we continue to experience significant increases in costs.

**Q. You mentioned earlier that as Avista removes old worn-out equipment and replaces it with new, it results in higher overall costs. Why does this cause Avista’s costs to go up when the Company has a depreciation component included in retail rates to help cover the cost to replace facilities?**

A. Avista’s retail rates are cost-based, which means the prices customers are paying today for transformers, distribution poles, substations, and transmission lines, among other facilities, are based on the cost to install those facilities, in some cases, 40-, 50-, and even 60-years ago. The cost of the same equipment and facilities today are many times more expensive. The depreciation component built into retail rates today is based on the much lower cost to install those facilities many years ago. Therefore, the depreciation component in retail rates covers only a small fraction of the annual costs associated with the replacement of facilities.

Let me give you an example. The chart below provides a comparison of the relative cost of a distribution power pole in 2010, and for points in time 10-, 20-, 30-, 40- and 50-years ago. The chart shows that distribution poles are over ten times more expensive today than they were fifty years ago.

**Illustration No. 1:**



Company witness Mr. DeFelice provides additional details related to the significant increase in the costs of utility materials and equipment.

The distribution pole and transformer shown in Illustration No. 2 below are 1930s’ vintage, and the pole has deteriorated to the point where it needs to be replaced. We have over 240,000 distribution poles in our electric system. Based on a 40-year depreciable life, we would need to replace approximately 6,000 poles every year.

**Illustration No. 2:**



The replacement of distribution poles represents a fraction of the infrastructure that needs to be replaced each year. In the next five years, our relatively small Company will need to spend approximately $1.2 billion of capital on utility generation, transmission and distribution facilities and other requirements. This $1.2 billion represents over 54% of the current rate base of approximately $2.2 billion dedicated to serving customers today. Utility equipment and facilities are big and expensive, and the required investment in new facilities is one of the major reasons that we need an increase in retail rates.

**Q. Does growth in Avista’s electric and natural gas retail sales revenue help cover the growth in net plant investment over time?**

A. Only very little. Our investment in facilities used to serve customers is growing at a much faster pace than retail sales. The red line on the graph below shows the actual change in Avista’s actual net plant investment from 2005 to 2011, and the forecasted change for 2012 to 2015. The purple and blue lines on the graph show the changes in retail kilowatt-hour (kWh) sales and retail therm sales, respectively, for the same time period. The chart clearly shows that net plant investment is growing at a much faster pace than sales. In fact, total therm sales in 2011 are about the same as in 2005, despite the addition of approximately 35,000 new customers being added during that timeframe. Total electric sales from 2005 to 2011 grew 5.76%, which is equal to only 0.96% per year.

The graph also shows this mismatch in new investment and new sales is forecasted to continue to the future. Therefore, retail rates must be increased to cover this increase in net plant investment, since sales growth is slow. The green line on the graph also shows that non-fuel operations and maintenance (O&M) expenses are growing at a faster pace than sales.

**Illustration No. 3:**

**Q. What is driving the increase in non-fuel O&M costs?**

A. Total utility non-fuel O&M increased approximately $72 million over the six-year period from 2005 to 2011. Although increasing labor and employee benefit costs, such as medical costs and retirement plan costs, are part of this increase, there have also been significant increases in other costs. In recent years there has been a significant increase in costly, mandatory requirements on utilities related to, among others things, reliability, environmental compliance, safety, and security. These mandates, together with litigation and other claims related to the ownership and operation of hydroelectric resources, have added, and continue to add, significant costs to run the utility. The penalties associated with non-compliance with some of these requirements can be as much as $1 million per day per violation. A few examples of the costs associated with these requirements are provided below:

1. **Hydro-electric Plant Relicensing** -- Under federal law we must have a license to operate our hydro-electric projects to serve customers. In recent years we negotiated new licenses for the projects on both the Clark Fork and Spokane rivers. The cost to gain new licenses was over $40 million up front and approximately $600 million over the life of the new licenses (45 to 50 years). These costs reflect aggressive bargaining on the part of the Company to keep the costs as low as possible. The requirements in the new long-term licenses address environmental and cultural protection while preserving our low-cost hydroelectric resources for the benefit of our customers, but they also represent significant increases in costs associated with owning and operating our hydro-electric system. The increase in annual expenses from 2005 to 2011 is approximately $5 million.

2. **Compliance with Mercury Emissions** -- There are new mercury emission limitation requirements in Montana effective in 2010 related to our ownership interest in the Colstrip Generating Projects that required capital investment up front and annual costs of $1.5 million per year (Avista share).

3. **Federal Reliability Requirements** -- The Energy Policy Act of 2005 changed the national reliability standards for utilities, enforced by the North American Electric Reliability Corporation (NERC), from voluntary to mandatory beginning June 2007. Non-compliance with any of the requirements may result in monetary penalties up to $1 million per day per violation. The planning standards require utilities to perform planning studies at least 10 years in the future to ensure sufficient facilities are in place to avoid real time loss of customers or impact to neighboring utilities for the loss of transmission facilities. If a potential violation is observed in the future analysis, then Avista must develop a project plan to ensure that the violation is fixed prior to it becoming a reality. Avista budgets for future projects and ensures that the design and construction of the required projects are completed prior to the time they are needed. A Compliance Manager and Analyst was hired to coordinate the Company’s compliance program. The Company also added an additional System Operator to allow adequate time for operator training, a Training Coordinator to train, track and manage all the extensive training needs and continuing education hours required for System Operators to maintain certification, and two additional engineers to support the new Critical Infrastructure Protection standards. Avista was required to construct a redundant Backup Control Center at a cost of approximately $6 million to meet one of the emergency operating standards. Avista also has approximately 25 subject matter experts that spend anywhere from 10-30% of their time working on compliance initiatives and documentation.

There are other significant cost increases from 2005 to 2011 in areas such as compliance with Sarbanes/Oxley and information technology related to cyber security and increased automation. Although we have taken extensive measures to ensure that the costs that we incur represent the most cost-effective and reliable way to continue to serve our customers, we continue to experience significant increases in annual operating expenses.

**Q. Why is Avista experiencing low sales growth?**

A. The slow growth in our sales is due in part to the continuing slow economy in our region. But the Company has also had aggressive energy efficiency programs in place for many years, which are designed to assist our customers in using less energy. While the partnership with our customers to conserve energy reduces the need to build new, expensive generating resources, it also limits the growth in revenue to cover increases in other investment and costs.

**Q. Are other utilities experiencing the same kinds of issues related to the need to invest in utility infrastructure to maintain a reliable system, as well as increasing O&M costs?**

A. Yes. Other electric utilities, whether consumer-owned or investor-owned, are also increasing their rates on a more regular basis, and this will likely continue into the near future. It is simply not possible to cuts costs enough to fully offset other cost increases and the costs associated with new plant investment.

Illustration No. 4 below identifies some of the recent rate increases for utilities in the Pacific Northwest that have either already occurred, or proposals that are currently pending.

**Illustration No. 4**

**Q. Have the rate increases that Avista has received in recent years allowed the Company the opportunity to earn the return on equity authorized by the UTC?**

A. No. Mr. Norwood, in his testimony, explains that even though we have filed rate cases each year for a number of years, our earned return on equity[[2]](#footnote-2) in Washington has been well below the return the Commission has determined to be reasonable. The bar chart in Illustration No. 5 below shows Avista’s earned return on equity (ROE) each year from 2007 to 2011 for our combined electric and natural gas operations in the State of Washington, under normalized operating conditions. The ROEs range from 6.2% to 8.1%, and are all well below ROEs approved by the Commission in recent years for utilities in Washington.

**Illustration No. 5**



**III. SUMMARY OF RATE REQUESTS**

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

A. Avista is proposing an increase in electric billed retail rates, before the proposed ERM rebate, of $41.0 million or 8.8%. The Company’s request is based on a proposed rate of return of 8.25% with a common equity ratio of 48.4% and a 10.9% return on equity. Avista is requesting an overall net electric billed rate increase of 5.9%. This proposed 5.9% bill increase is composed of the proposed billed rate increase of 8.8%, and a proposed one-year Energy Recovery Mechanism (ERM) bill decrease (rebate to customers) of 2.9%.

Company witness Mr. Ehrbar will provide details related to the proposed ERM rebate to customers and the proposed rate spread and rate design. The proposed rate spread for the increase to each electric customer class is shown in the illustration below.

**Illustration No. 6:**



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

 A. With regard to natural gas, the Company is requesting an increase of $10.1 million or 6.8% in billed rates. As with the electric increase, the Company’s request is based on a proposed rate of return of 8.25% with a common equity ratio of 48.4% and a 10.9% return on equity. The proposed rate spread for each natural gas customer class is shown in the illustration below:

**Illustration No. 7:**

 Service Schedule Proposed Increase

 General Service Schedule 101 6.9%

 Large General Service Schedule 111 6.9%

 Extra Large General Service Schedule 121 6.8%

 Interruptible Sales Service Schedule 131 6.6%

 Transportation Service Schedule 146

 (excluding natural gas costs) 7.0%

 **Overall Increase 6.8%**

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

A. The Company’s electric general rate case is based on a 12-months ending December 31, 2011 test period, and a January 1, 2013 through December 31, 2013 pro forma rate period. The Company’s electric request is driven primarily by four components or columns shown in Illustration No. 8 below.

The largest column, representing increases in Net Plant Investment, comprises approximately 86% of the overall request, and is due to an increase of approximately $82.7 million in net rate base for the Washington jurisdiction, reflected in the pro forma and attrition adjustments in this case.

The next three columns represent the following: 1) the Production and Transmission Expense column shows a net reduction of 11%, related to decreases in net power supply and transmission expenditures; 2) the Distribution and Other Expense column shows a net increase of 8%, related to increases in net operation and maintenance (O&M) and administrative and general (A&G) expenses; and lastly 3) the Demand Side Management (DSM)/Retail Revenue Credit Adjustments column shows a net increase of 17%, representing the cost related to a shortfall in current and future revenues experienced by the Company for its DSM energy efficiency programs and the impact of necessary corrections to the retail revenue credit rate.

**Illustration No. 8:**



Later witnesses provide details explaining these changes in costs.

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

A. The Company’s natural gas request is driven primarily by increases in net plant investment and changes in various operating cost components, mainly distribution operation and maintenance and administrative and general expenditures.

**Q. Is the Company proposing any changes to the cost of natural gas for its retail natural gas customers in this case?**

A. No. Avista is not proposing changes in this filing related to the cost of natural gas included in current rates for natural gas customers. Changes in natural gas costs are addressed in the annual Purchase Gas Adjustment (PGA) filings.

**Q. How do Avista’s retail rates compare to other utilities in the Northwest and across the country?**

A. Edison Electric Institute prepares an annual comparison of residential electric bills for investor-owned utilities across the country. Illustration No. 9 provides a comparison of an Avista customer’s monthly bill[[3]](#footnote-3) in Washington and Idaho, with utility bills in other states. The chart shows that Avista’s residential customers’ rates are the lowest, or are among the lowest, in the Country.

**Illustration No. 9**

**Average Residential Monthly Electric Bill
1,000 Kilowatt-Hours per Month
July 2011**



***Source:***  *Edison Electric Institute Investor-Owned Utilities. Based on 1,000 kWh of use per month as of July 1, 2011*

Our relatively low retail rates are due in large part to a history of our Company aggressively pursuing the acquisition and preservation of a diversified portfolio of low cost resources for the benefit of our customers. This portfolio includes hydroelectric, wood-waste fired, gas-fired baseload, gas-fired peakers, and coal-fired generation, together with long-term purchases of power and an aggressive energy efficiency program.

Our low rates are also a result of Avista’s aggressive efforts to control its costs, in order to keep retail rates as low as reasonably possible.

**Q. Are there any recent examples that you would like to highlight?**

A. Yes. On March 7, 2012, Washington Governor Christine Gregoire signed a biomass energy bill (SB5575), which qualifies legacy biomass energy (built before 1999) as an eligible renewable resource for purposes of meeting Washington State Renewable Portfolio Standards (RPS). As a result of the bill’s passage, the energy generated at Avista’s Kettle Falls biomass plant will qualify to meet our RPS requirements, beginning in 2016. The passage of the bill will save our customers millions of dollars over the long-term, because Avista can now use existing renewable power to meet some of our State mandates, which reduces the need to buy renewable energy credits or invest in development of new renewable energy resources.

This multi-year legislative effort, led by Collins Sprague, Avista’s Government Relations Manager in Washington, is an example of Avista’s ongoing efforts to advocate on behalf of our customers. By engaging in policy-making at local, state and federal levels, we can affect changes that help benefit our customers, communities and the environment.

**IV. COST MANAGEMENT AND EFFICIENCIES**

**Q. Is Avista continuing to pay particular attention to controlling its costs in order to mitigate the level of price increases to its customers?**

A. Yes. In the last several years we have renewed our efforts to control our costs and improve efficiency, while continuing to meet our reliability and environmental compliance requirements, and preserving a high level of customer satisfaction. We are focused on long-term, sustainable savings to continuously improve our service to customers and manage costs into the future.

Some of our continuing efforts are briefly explained below, as well as a number of more recent initiatives.

**Hiring Restriction**

The Company continues to operate under a hiring restriction which requires approval by the Chairman/President/CEO, President of the Utility, the CFO, and the Sr. VP for Human Resources for all replacement or new hire positions.

**Limitations on Capital Spending**

Avista approved a lower capital budget than was requested by the Company’s Engineering and Operations personnel. The original capital projects request for approval in 2011 consisted of projects totaling over $269 million. The Capital Prioritization Committee reduced the list of recommended projects by $19 million to the $250 million capital budget approved by the Board. In addition, the Company prioritized O & M facility maintenance and improvement projects and removed projects that could be delayed without safety or operational concerns.

**Reduced Pension Benefit for New Hires**

As part of the new contract negotiated with Avista’s bargaining unit employees, the Defined Benefit Pension Plan’s benefit formula was reduced by approximately 28% for all bargaining unit new hires, effective January 1, 2011. This change was earlier made for non-bargaining unit employees effective January 1, 2006.

**Refinance Long Term Debt**

As explained by Company witness Mr. Thies, the Company is working to assure there are adequate funds for operations, capital expenditures and debt maturities.  We have extended the average weighted maturity of long-term debt to 14.88 years from 14.75 years, with an ­­­­overall cost of debt of 5.76% as of December 31, 2011.

During 2010 and 2011, the Company issued long-term debt at historically low rates that included two thirty year bond issuances, a ten year bond issuance, and a three year bond issuance. Cumulatively, these issuances extended the weighted average maturity of outstanding debt.  The following are details of these issuances:

December 2011:

* $85.0 million of secured debt at a coupon of 4.45 percent due in 2041.

December 2010:

* $52 million of secured debt at a coupon of 3.89% due in 2020;
* $35 million of secured debt at a coupon of 5.55% due in 2040; and
* $50 million of secured debt at a coupon of 1.68% due in 2013.

**Performance Excellence Initiative**

In May 2010, the Company enlisted the help of Booz & Company to work with us on what we have referred to as Performance Excellence. They brought with them industry knowledge, expertise and a [phased-approach](http://avanet.avistacorp.com/news/company/eview/2010/05-11-2010_EXTRA.asp). Phase 1 involved assessing and identifying Avista’s [top opportunities](http://avanet.avistacorp.com/news/company/eview/2010/07-15-2010_EXTRA.asp) to better align our resources so we can run our business more efficiently, and be better prepared to meet customers’ future needs for energy and energy information. In [Phase 2](http://avanet.avistacorp.com/news/company/eview/2010/09-07-2010_EXTRA.asp) we are designing processes to capture these opportunities. One example of these opportunities is within our Fleet Department. Fleet utilization is really focused on ensuring that we have the right mix of vehicles at the right place and the right time. It is the Company’s goal to reduce fleet by five percent over the next three years (sixty vehicles). To date we have turned in 25 vehicles that were not replaced.

We recognize that our proposed rate increases will result in energy bills that will be more difficult for some of our customers to pay. The Company proposes to increase its low-income rate assistance funding for electric and natural gas service by a percentage amount equal to the percentage rate increase granted in this case for residential customers.

I can assure you that we are not just sitting on the sidelines as our costs go up, as evidenced by the measures described above and others explained in more detail by Company witness Mr. Kopczynski.

**V. COMMUNICATIONS WITH CUSTOMERS**

**Q. How is Avista communicating with its customers to explain what is driving increased costs for the Company?**

A. The Company proactively communicates with its customers in a number of ways: electronic communications on issues of importance to them, customer forums, one-on-one customer interactions through field personnel and account representatives, bill inserts, social media, media contacts, group presentations, and through our employees’ involvement in community, business and civic organizations, to name a few. We believe our communications are helping our customers and the communities we serve to better understand the issues faced by the Company, such as increased environmental mitigation, infrastructure investment and generation constraints, all of which have led to higher costs for our customers.

We have listened to our customers and learned that they want information and conversations with Avista employees to better understand the choices they have to manage how they use energy and the forces that are impacting their energy prices.

That’s why we are continuing to build on our communications, so that customers receive information directly from us on issues important to them. We are also continuing to engage employees in the Company in our efforts to more directly communicate with customers.

**Q. How has the Company stepped-up communications with its customers?**

A. One of the important principles in our intensified outreach is to meet customers where they gather. Our customer conversation uses traditional and non-traditional communication channels, including one-on-one and group presentations, print, radio, website, newsletters, videos, social media and direct emails.

One important customer segment that we target are those customers who gather online. We are continuing to focus on our social media program with the Avista blog as our foundation. We also communicate on Twitter©, in online discussion forums when appropriate and this year have added the Avista Utilities Facebook© page. For customers who want a more private online conversation, we offer customers a conversation email account to make sure they’re comfortable communicating with us.

One important customer communication channel is our website at [www.avistautilities.com](http://www.avistautilities.com). A section focusing on rates provides customers a video on how rates are set, including the regulatory process; other videos focus on the components of general rate requests, and provided additional information on general rate requests.

Our employees provide excellent customer service, and this focus on communicating with our customers includes providing them messaging and new tools and training to make it easier to have conversations about Avista with friends, family and customers. We are finding that once a customer talks with one of our employees and has the opportunity to voice their concerns and receive answers to their questions, their satisfaction level increases significantly. We’re listening to our customers’ point-of-view and sharing ours about energy issues that directly affect us all.

We are continuing our focus on informing customers of the many programs we offer to provide assistance in managing their energy bills, and ensuring that our employees are equipped to engage in these conversations. Also, we are continuing to build understanding on how decisions today, specifically in areas such as energy efficiency, reliability and new renewable energy, will affect our energy future.

**Q. What are some of the topic areas you are focusing on as you communicate with your customers?**

A. Among other areas, we are increasing our efforts to directly address some of the issues raised by our customers in their comments to the Commission. For example, our proxy statement issued each year prior to our annual shareholder meeting includes compensation information for each of our top five executive officers. This information is usually published in our local newspaper, which triggers comments from our customers to the Commission, letters to the editor, and a flurry of activity on social media.

Many of the comments suggest that our customers believe all, or the majority, of the compensation reflected in the proxy is being included in the retail rates approved by the Commission. The stakeholders involved in the ratemaking process know this is not true, but many of our customers do not. So we are providing more information to our customers. In fact, as Company witness Ms. Feltes explains in her testimony, none of the long-term incentive compensation is included in customers’ rates, and even a portion of the base salary of officers is allocated to our subsidiary operations and is not paid by our customers. Approximately 42% of the total executive officer salaries and short term incentives are included in retail rates for customers in Washington, Idaho and Oregon. Washington’s portion, included in retail rates, is approximately 25% of the total. Ms. Feltes provides additional details related to Avista’s compensation for all employees, including officers.

**Q. Is Avista providing additional information to customers related to Company profits?**

A. Yes. Following each quarter we issue an earnings release that details the profits for Avista Corp., including the utility and our subsidiary operations. Some of the comments from our customers, in response to the earnings release, suggest that they believe the profits are excessive, or represent dollars that are over and above what is needed to own and operate the utility. So we are making more information available to explain that the utility profit is not excess profit, but represents a rate of return for our common equity shareholders for the use of their money to finance the utility infrastructure used to provide service to them, and therefore, it is an essential cost of owning and operating the utility.

**Q. Are there any other topics the Company is emphasizing in its communications?**

A. Yes. There are other related areas that I have already addressed earlier in my testimony, and I will not belabor them here. Some of our customers believe that our annual depreciation expense should cover the cost to replace our old facilities, and others have wondered why we are still talking about replacing our aging infrastructure when we did that last year and the year before.

Therefore, we are providing more information to our customers to explain, as I illustrated earlier, that the cost of new facilities is multiple times more expensive than the old facilities, and the annual depreciation expense we are currently collecting in retail rates is well below what is needed to cover the cost of new facilities. And with each passing year, our facilities are getting older and we need to replace some of them every year to maintain a safe, reliable system.

We believe our communication efforts; including both the content as well as the avenues in which we are communicating, are helping more customers better understand why we need to increase retail rates on a regular basis.

**VII. CUSTOMER SATISFACTION**

**Q. What kind of feedback are you receiving from customers related to customer satisfaction?**

A. I am pleased with the dedication of Avista Utilities’ employees and their commitment to provide quality service to our customers. As I indicated earlier, while we continue to maintain tight controls on capital and O&M budgets, our customer service surveys indicate that customer satisfaction remains high. Our overall customer satisfaction from our voice-of-the-customer surveys in the fourth quarter of 2011 was 95% in our Washington, Idaho, and Oregon operating divisions. This rating reflects a positive experience for customers who have contacted Avista related to the customer or field service they received. These results can be achieved only with very committed and competent employees.

**VII. CUSTOMER SUPPORT PROGRAMS**

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

A. More than 360,450 electric and 320,741 natural gas customers in three states rely on Avista for their electricity and natural gas services. One of the challenging aspects of the utility business is to receive payment from those least able to pay. In the past few years, this challenge has broadened with the serious economic impact the national recession has had on individuals and businesses.

Avista is committed to reducing the burden of energy costs for our customers most affected by rising energy prices, including low income individuals and families, seniors, disabled and vulnerable customers. To assist our customers’ in their ability to pay, the Company focuses on actions and programs in four primary areas: 1) advocacy for and support of programs providing direct financial assistance; 2) low income and senior outreach programs; 3) energy efficiency and energy conservation education; and 4) support of community programs that increase customers’ ability to pay basic costs of living.

In the 2010/2011 heating season, 37,624 Washington customers received approximately $12 million in various forms of energy assistance (Federal LIHEAP program, LIRAP, Project Share, and local community funds).Some of the key programs that we offer or support are as follows:

1. **Low-Income Rate Assistance Program (LIRAP).** Avista’s Low Income Rate Assistance Program in Washington collects approximately $6.3 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 2010/2011 heating period for example, the LIRAP funds supplied close to 8,288 grants to our customers.

2. **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 2011, Avista Utilities’ customers donated $302,505 on a system-wide basis, of which $183,393 was directed to Washington Community Action Agencies. In addition, the Company contributed $138,200 to Project Share for the benefit of Washington customers in 2011.

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.

5. **CARES Program.** Customer Assistance Referral and Evaluation Services provides assistance to special-needs customers through access to specially trained (CARES) representatives who provide referrals to area agencies and churches for help with housing, utilities, medical assistance, etc.

These programs and the partnerships we have formed with community action agencies have been invaluable to customers who often have nowhere else to go for help. Company witness Mr. Kopczynski provides additional detail in his testimony concerning these and other programs designed to assist customers.

VIII. OTHER COMPANY WITNESSES

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

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

Mr. Mark Thies, Senior Vice President and Chief Financial Officer, will provide a financial overview of the Company and will explain the overall rate of return proposed by the Company in this filing for its electric and natural gas operations. The proposed rate of return is derived from Avista’s total cost of debt including long-term and short-term debt, and common equity, weighted in proportion to the proposed capital structure. In brief, he will provide information that shows:

* Avista’s plans call for significant capital expenditure requirements for the utility over the next two years to assure reliability in serving our customers and meeting customer growth. Capital expenditures of approximately $500 million are planned for 2012-2013 for customer growth, investment in generation upgrades, transmission and distribution facilities, and information technology systems as well as necessary maintenance and replacements of our natural gas utility systems. Capital expenditures of approximately $1.2 billion are planned for the five-year period ending December 31, 2016. Avista needs adequate cash flow from operations to fund these requirements, together with access to capital from external sources under reasonable terms.
* Avista’s corporate credit rating from Standard & Poor’s (S&P) is currently BBB and Baa2 from Moody’s Investors Service (Moody’s). Avista must operate at a level that will support a solid investment grade corporate credit rating in order to access capital markets at reasonable rates, which will positively affect long-term costs to customers. A supportive regulatory environment is an important consideration by the rating agencies when reviewing Avista. Maintaining solid credit metrics and credit ratings will also help support a stock price necessary to issue equity under reasonable terms to fund capital requirements.
* The Company is proposing an overall rate of return of 8.25%, including a 48.4% equity ratio and a 10.90% return on equity. Our pro forma cost of debt is 5.76%.

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

* In order to reflect the risks and prospects associated with Avista’s jurisdictional utility operations, his analyses focused on a proxy group of twenty-six other utilities with comparable investment risks. Consistent with the fact that utilities must compete for capital with firms outside their own industry, he also references a proxy group of comparable risk companies in the non-utility sector of the economy;
* Because investors’ required return on equity is unobservable and no single method should be viewed in isolation, he applied the DCF, CAPM, and risk premium methods, as well as the expected earnings approach, to estimate a fair ROE for Avista;
* Based on the results of these analyses, and giving less weight to extremes at the high and low ends of the range, Dr. Avera concluded that the cost of equity for the proxy group of utilities is in the 10.0 percent to 11.4 percent range, or 10.2 percent to 11.6 percent after incorporating an adjustment to account for the impact of common equity flotation costs; and,
* Avista is requesting a fair ROE of 10.9 percent, which is equal to the midpoint of his recommended range. Considering capital market expectations, the exposures faced by Avista, and the economic requirements necessary to maintain financial integrity and support additional capital investment even under adverse circumstances, it is Dr. Avera’s opinion that 10.9 percent represents a fair and reasonable ROE for Avista.

Mr. Kelly Norwood, Vice-President, State and Federal Regulation, will show that utility operating expenses and capital investment (rate base) are growing at a much faster pace than retail revenues, and explain how the ratemaking practices we are currently using in Washington are not designed to provide timely recovery of costs, along with a fair return on investment, under these circumstances. He will also present some of the specific indicators and objective measures that show the nature and extent of the revenue shortfall.

Dr. Mark Lowry, President of Pacific Economics Group (“PEG”) Research LLC., addresses the challenge of chronic underearning that the Company faces today under the largely traditional approach to regulation that is used by the UTC. He will first explain the underearning problem in general terms. Dr. Lowry then discusses his research to assess the attrition in Avista’s Washington electric operations that will result through 2013 from new rates that are based solely on conventional rate setting methods and provides the Attrition Adjustment proposed in the Company’s filing. As stated by Dr. Lowry, the Attrition Adjustment portion of the overall revenue requirement determined by his attrition study is approximately $21.6 million.

**Revised May 25, 2012**

Mr. Robert Lafferty, Director of Power Supply, will provide an overview of Avista’s resource planning and power supply operations. This includes summaries of the Company’s generation resources, the current and future load and resource position, future resource plans, and an update on the Company’s plans regarding the acquisition of new renewable resources, including the power purchase agreement with Palouse Wind, LLC. As part of an overview of the Company’s risk management policy, he will provide an update on the Company’s hedging practices. He will also address hydroelectric and thermal project upgrades, followed by an update on recent developments regarding hydro relicensing.

Mr. Clint Kalich, Manager of Resource Planning & Power Supply Analyses, will describe the Company’s use of the AURORAXMP dispatch model, or “Dispatch Model.” He will explain the key assumptions driving the Dispatch Model’s market forecast of electricity prices. The discussion includes the variables of natural gas, Western Interconnect loads and resources, and hydroelectric conditions. He will also describe how the model dispatches its resources and contracts to maximize customer benefit and tracks their values for use in pro forma calculations. Finally, he will present the modeling results provided to Company witness Mr. Johnson for his power supply pro forma adjustment calculations.

Page 31 (Revised)

Mr. William Johnson, Wholesale Marketing Manager, will 1) identify and explain the proposed normalizing and pro forma adjustments to the 2011 test period power supply revenues and expenses; 2) identify and explain proposed modifications to the Energy Recovery Mechanism (ERM); and 3) describe the proposed level of expense and retail revenue credit for ERM purposes, using the pro forma costs proposed by the Company in this filing.

Mr. Kevin Christie, Director of Gas Supply, will describe Avista’s natural gas procurement planning process for retail distribution service, provide an overview of the Company’s 2012 Natural Gas Integrated Resource Plan development, and also provide an overview of the Jackson Prairie natural gas storage facility (JP Storage).

Mr. Don Kopczynski, Vice President of Customer Solutions, will describe Avista’s electric and natural gas energy delivery facilities and operations, and recent efforts to increase efficiency and improve customer service. He will describe Avista’s three Smart Grid projects that have received grants through the Department of Energy (DOE). He will also explain some of our efforts to control costs, increase efficiency, and improve customer service. He will also discuss the replacement of the Company’s legacy customer information system (CIS), as well as summarize Avista’s customer support programs in Washington. Finally, he will address the Company’s plans to replace Aldyl A piping in our natural gas distribution system.

Mr. Scott Kinney, Director, Transmission Operations, will discuss the electric transmission and distribution capital investments planned for 2012 and 2013, as well as projects associated with the Company’s Asset Management Program.

Mr. Dave DeFelice, Senior Business Analyst, will cover the Company’s proposed pro forma adjustment for capital investments in utility plant for the 2011 test period. He will also discuss the planned 2012 and 2013 capital investment activity. In addition, his testimony and exhibits will cover the Company’s proposed changes in depreciation rates pertaining to electric and natural gas plant-in-service using the recently completed depreciation study.

Ms. Karen Feltes, Senior Vice-President, Human Resources and Corporate Secretary, will provide an overview of Avista’s overall compensation philosophy. She will provide an overview of the benefit plans offered by the Company, including a discussion of the increasing costs related to Avista’s defined benefit retirement plan and post-retirement medical costs. She will also provide an overview of the employee Incentive Plan. Finally, in accordance with Order No. 06 in Dockets UE-110876 and UG-110877, Ms. Feltes will provide a summary and explanation of the appropriateness of amounts of executive compensation included in retail rates.

Ms. Elizabeth Andrews, Manager of Revenue Requirements, will explain the accounting and financial data in support of the Company's need for the proposed increase in rates. She will explain the pro formed operating results, including expense and rate base adjustments made to actual operating results and rate base, including the Washington share of the proposed adjustments of other witnesses in this case. In addition, I have incorporated the impact of “attrition” in the overall revenue requirements. Lastly, she will explain the Company’s compliance with the UTC Commission Order No. 6 in Docket Nos. UE-110876 and UG-110877, regarding 1) the Company’s deferred accounting treatment for the variability in thermal generating plant maintenance costs, 2) the tracking of Washington general rate case expenses and 3) the internal audit of accounting practices.

Ms. Tara Knox, Senior Regulatory Analyst, covers the Company’s electric and natural gas cost-of-service studies performed for this proceeding. Additionally, she is sponsoring the electric and natural gas revenue normalization adjustments to the test year results of operations and the proposed retail revenue credit rate to be used in the Energy Recovery Mechanism (ERM) as well as the associated retail revenue credit pro forma adjustment.

Mr. Patrick Ehrbar, Manager of Rates and Tariffs, discusses the spread of the proposed annual revenue changes among the Company’s general service schedules as well as the proposed rate design within each schedule. He explains, among other things, that:

* The proposed increase in electric base rates is 9.0%, which consists of an increase in electric base retail revenues of $41.0 million.
	+ - Including the proposed ERM Rebate, the monthly bill for a residential customer using an average of 989 kWhs per month would increase from $78.97 to $83.91 per month, an increase of $4.94 or 6.3%. This includes the proposed increase in the monthly basic or customer charge from $6.00 to $10.00
* The proposed natural gas annual revenue increase in base rates is $10.1 million, or 7.0%.
* The monthly bill for a residential customer using 68 therms per month would increase from $61.55 to $65.78 per month, an increase of $4.23 or 6.9%. This includes the proposed increase in the monthly basic or customer charge from $6.00 to $10.00.

In addition, he will provide further information related to the Company’s proposed increase in the basic charge, the proposed ERM Rebate, the impact of sales on DSM, and provides an overview demonstrating how the Company met the requirements from the Order and Settlement Stipulation approved in Docket Nos. UE-110876 and UG-110877.

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

1. Yes.
1. The Company has requested an overall electric base rate increase of 9.0% and an overall natural gas base rate increase of 7.0%. The proposed general increase over present electric billing rates, including all other rate adjustments (DSM and Residential Exchange) is 8.8%, and including the proposed ERM Rebate, is 5.9%. The proposed general increase over present natural gas billing rates, including all other rate adjustments (DSM, Decoupling and Gas Rate adjustment) is 6.8%. [↑](#footnote-ref-1)
2. Avista’s authorized ROEs in recent settlements approved by the Commission were not separately identified. However, in Avista’s prior Docket UE-100467 & UG-100468 (consolidated), the Commission authorized a 10.2% return on equity. [↑](#footnote-ref-2)
3. Based on a residential customer’s average usage of 1,000 kWh per month. [↑](#footnote-ref-3)