Exhibit No. __(BJH-1T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UG-060518

DIRECT TESTIMONY OF

BRIAN HIRSCHKORN

REPRESENTING AVISTA CORPORATION

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

A. My name is Brian J. Hirschkorn and my business address is 1411 East Mission Avenue, Spokane, Washington. I am presently assigned to the Rates Department as Manager of Pricing.

Q. Have you previously testified before this Commission?

A. Yes, I have previously testified in numerous proceedings as the Company's rate design witness.

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

A. My testimony will describe the Company's proposed decoupling mechanism (Mechanism). I will also provide an overview of the developments regarding the Company's proposed Mechanism that have occurred since the Company filed a Petition requesting approval of its Mechanism on April 4, 2006.

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

A. Yes, I am sponsoring Exhibit No. __(BJH-2), which consists of five pages. I will refer to these Exhibit pages later in my testimony.

<u>Introduction</u>

Q. Could you briefly describe the developments you referred to earlier that have occurred since the Company filed its Petition in April?

A. Yes. As previously stated, the Company filed a Petition, dated April 4, 2006, requesting the Commission to approve a proposed Natural Gas Decoupling Mechanism. The

Company also provided a copy of the Petition to representatives of Public Counsel, the Northwest Industrial Gas Users, the Northwest Energy Coalition, the Washington Energy Policy Group (Department of Community Trade and Economic Development or "CTED") and the Spokane Neighborhood Action Program.

At the suggestion of Commission Staff, a workshop was held on May 17th at the Commission's office to discuss the Company's proposed Mechanism. Representatives of all of the aforementioned organizations were present, as well as a representative of The Energy Project. During the workshop, the Company described its proposed Mechanism, answered questions, and received feedback from the other parties. On June 28th, a second workshop was held at the Commission's office to further discuss any outstanding issues regarding the proposed mechanism. Although the Company and the other parties were not able to reach agreement on all issues, the Company filed an Amendment to its original Petition on August 7th to address several issues raised by the other parties.

Q. What are the issues addressed in the Amendment filed by the Company?

A. The issues addressed in the Amendment are:

- Revision of the proposed effective date of the Mechanism
- Refinement in the determination of new customer usage applied in the monthly revenue deferral calculation
- Revised DSM achievement levels used to determine the level of recoverable deferred revenue recorded under the Mechanism
- Additional evaluation of the Company's annual DSM results
- Future evaluation of the Mechanism

All of the issues will be discussed in more detail later in my testimony.

Q. Is the Company proposing any revisions to its Mechanism beyond the items addressed in the Amendment(s) set forth in its letter dated August 7, 2006?

A. The only revision is to the proposed implementation date and proposed (pilot) term of the Mechanism. Based on the procedural schedule established in this Docket, the Company proposes that implementation of the Mechanism begin February 1, 2007, whereby deferred revenue entries would begin being recorded for that month. The proposed term of the Mechanism would be 2 years and 5 months for the recording of deferred revenue (February 2007 – June 2009). However, the proposed amortization period would remain at three years, beginning in the fall of 2007 and ending in the fall of 2010. I will discuss this in more detail later in my testimony.

Q. Why is the Company requesting approval of a decoupling mechanism at this time?

A. The increase in the cost of natural gas over the past several years makes consideration of a natural gas decoupling mechanism especially important at this time. The increased cost of natural gas, projections of continued high prices in the future, and the fragile balance between supply and demand, make it increasingly important to focus on effective long-term efficiency and conservation measures. However, because the Company's current rate structures provide recovery of the majority of its fixed costs on a per-therm (sales volume) basis, energy efficiency and conservation objectives are directly at odds with the recovery of the fixed costs of providing service. The proposed decoupling mechanism would break the link between the volume of therm sales and the recovery of fixed costs and would provide for an increased focus on energy efficiency and conservation.

Q. Has the Company seen natural gas use per customer decrease in recent years?

A. Yes. From 1999 to 2005, the Company's Washington residential and small commercial (Schedule 101) gas customers reduced their average usage by 13.5%, on a weather-corrected basis. Since 2004, Avista has implemented two natural gas general rate increases for Washington customers. A primary cause of these increases was the reduction in customer usage that resulted in an under-recovery of fixed costs (margin).

The rates established in a general rate proceeding are designed to provide full recovery of the costs of providing service to customers. When the majority of fixed costs are recovered through sales volumes, and sales volumes are lower than expected, the recovery of fixed costs falls short of the level authorized by the Commission. An effective decoupling mechanism, which separates the recovery of fixed costs from sales volumes, is consistent with the ratemaking objective of authorizing rates that are designed to recover the fixed costs of providing service.

Q. Why is it reasonable for the Commission to consider the Company's proposed Mechanism outside of a general rate filing?

A. The Company believes it has addressed and resolved the two primary issues related to a decoupling mechanism that would otherwise be examined in a general rate proceeding. These two issues are: 1) the need for a recent "test-year" to establish a reliable base from which to measure a decoupling adjustment going forward, and 2) an assessment of the potential change in the gas utility's business risk given a decoupling mechanism. With regard to 1), Avista has recently completed a natural gas general rate case based on a 2004 test year with rates effective January 1, 2006. Accordingly, it has established a reliable base for the proposed decoupling mechanism.

With regard to 2), the Company's proposed mechanism does not significantly affect the Company's business risk going forward. Therefore, an adjustment to the Company's authorized Return on Equity (ROE) would not be warranted. The Company's proposed mechanism captures only the change in residential and commercial customers' usage resulting from natural gas conservation, energy efficiency and price elasticity. It does not capture: 1) changes in large customer usage often resulting from changes in business or economic conditions, or 2) changes in customer usage resulting from abnormal weather. These changes in customer usage that are not included in the Company's mechanism can be more substantial and affect the Company's business risk going forward. By excluding the variation in sales volume/margin caused by abnormal weather, the Company is still retaining the majority of risk associated with sales variability. Additionally, as will be described later, the mechanism includes an "earnings-test", a provision that would limit the level of any decoupling rate adjustment if the Company's earnings exceed its authorized rate of return.

Q. What benefits would the Company's proposed Mechanism provide to customers?

A. Approval of a decoupling mechanism as proposed by the Company would further promote energy efficiency and conservation. Increased conservation would not only benefit the individual customers participating in those measures through reduced bills, but would also reduce the overall demand for natural gas, which would help to reduce natural gas prices for all customers. Additionally, while a decoupling mechanism would not altogether eliminate the need for future general filings, it may serve to reduce the frequency and magnitude of general rate requests, resulting in smaller incremental rate increases over time.

Q. Could you briefly describe the Company's present natural gas Demand-Side-Management program?

A. The Company has had a natural gas Demand-Side Management program in place since the mid-1990's, and has worked closely with other stakeholders on DSM policy and programs. Funding for the DSM program is provided through the DSM tariff rider approved by the Commission in 1995. Although Avista has been a leader in the Northwest in implementing and supporting DSM programs, the proposed decoupling mechanism would align the Company's interest with that of its customers with an increased focus on effective DSM programs. As described later, the level of "lost margin" recovered through the Company's proposed mechanism will be directly tied to the Company's success in achieving the "target" level of natural gas DSM savings during the prior year. Mr. Powell's testimony provides additional information regarding the Company's natural gas DSM programs.

Proposed Decoupling Mechanism

Overview

Q. Could you please provide an overview of the Company's proposed Mechanism?

A. Yes. The mechanism is relatively easy to understand and implement, directly ties the recovery of lost margin to both an annual earnings-test and pre-established DSM targets, and provides adequate time for audit prior to implementing any rate adjustment. The mechanism would not require any changes to existing rate structures or the Company's billing system. The mechanism includes a relatively simple calculation of a monthly deferred revenue amount that reflects the difference between the weather-normalized margin (revenue less purchased gas costs) received by the Company compared to the level of margin during the corresponding month of the test year approved by the Commission in the Company's last general filing. The Mechanism would result in a single annual rate adjustment to be implemented coincident with the annual PGA adjustment. The incremental amount of the annual rate adjustment would be limited to no more than a 2% rate increase or decrease.

The mechanism would apply to the Company's natural gas Schedules 101 and 111, which include all residential and nearly all commercial customers, as well as small industrial customers. The mechanism would not be applicable to the Company's approximately 70 largest customers served under High Load Factor Schedule 121, Interruptible Schedule 131, Transportation Service Schedule 146, or special contracts.

Monthly Deferred Revenue Calculation

Q. Could you please describe the calculation of the monthly deferral in more detail?

A. Yes. The starting point for the proposed mechanism is the volume of therm sales for each month of the year from the Company's last general rate case (2004 test year).

The Company has calculated the weather-normalized calendar therm sales (Base Therm Sales) for each month of the 2004 test year, with the total for all twelve months matching the annual amount reflected in the test year.

Following the end of each month, the actual volume of weather-corrected therm sales for the calendar month (Current Therm Sales) would be determined and compared with the Base Therm Sales for the corresponding month. Prior to weather-correcting actual therm sales for the month, an adjustment is necessary to remove the usage associated with new customers added since the corresponding month of the test year. To the extent the Company has added customers since the test year, these new customers would increase Current Therm Sales as compared to the Base Therm Sales. Since the Company filed the Petition in April, it has developed a computer program that identifies new gas customers added since the corresponding month of the test year (2004). The program retrieves each customer's usage for the current month and provides a total current month usage amount for all new customers by rate schedule (Schedules 101 and 111). The total usage for new customers is subtracted from the total current month usage for each Schedule. This enhancement to the Mechanism was addressed in the Amendment to the Company's Petition, dated August 7, 2006.

Following the subtraction of usage for new customers, the net current month usage is weather-normalized. The coefficients (usage per degree-day per customer) used to determine the weather adjustment are the same as those used in the test year, thereby providing an "apples-to-apples" comparison between the two years. Following the adjustments for new customer usage and weather, the (net) Current Therm Sales for the month are compared with the Base Therm Sales to determine the difference in therm sales. This comparison captures only the effect of conservation and price elasticity for "existing" customers since the corresponding month of the test year.

The difference in usage is multiplied by the approved margin rate (sales rate less purchase gas cost per therm) to calculate the fixed distribution costs that are either under-recovered or over-recovered as compared to the test year. As Schedule 101 consists of a single rate for all usage, the margin rate is the same for all usage. As Schedule 111 consists of three usage/rate blocks, the Company proposes to use the (lowest) margin from the tail-block in order to avoid the complexities of determining weather-normalized usage by rate block. Ninety percent (90%) of these dollars, either positive or negative, are then recorded in a separate account for later recovery (or rebate).

Q. Could you please summarize the steps involved in calculating the monthly deferred revenue?

A. Yes. There are essentially five simple steps in calculating the amount of the monthly revenue deferral for each of the two rate schedules (101 & 111) included in the mechanism. These steps are as follows:

Step 1 – Subtract new customer usage from total actual usage

Step 2 – Weather-normalize net usage

Step 3 – Calculate difference in usage between current month and test year

Step 4 – Calculate the margin difference resulting from the usage difference

Step 5 – Record deferred revenue for 90% of the margin difference

Q. Would the Company use the 2004 test year usage as the Base Therm Sales for the entire (pilot) term of the Mechanism?

A. The Company is proposing a pilot term for the Mechanism that would include a monthly deferred revenue calculation through June 2009. The Company would continue to use the 2004 test year usage as the Base Therm Sales unless the Company files a natural gas general case, and the Commission issues an order in that case prior to June 2009. In that instance, the approved test year therm usage from that filing would be used to calculate deferred revenue for the remaining months of the proposed term.

Q. Does the Company propose to accrue interest on the deferred revenue balance?

A. Yes. Interest would be accrued on the deferred balance at the same rate applied to the Company's PGA deferral account.

Q. How and when does the Company propose to request a rate adjustment associated with the monthly deferrals calculated under the Mechanism?

A. The monthly deferred revenue would be accumulated through June of each year of the proposed pilot period. If the Mechanism is approved to be effective February 1, 2007, the Company would accumulate the monthly deferred revenue for February through June 2007. It would then file a request to implement a rate adjustment, coincident with the 2007 PGA rate adjustment, to amortize that deferred balance over a twelve-month period, subject to the "earnings" and "DSM" tests described later. For each of the two successive years, the Company would accumulate the deferred revenue for each July-June period, and file a request on or before September 1 to implement the appropriate rate adjustment coincident with the annual PGA.

Q. Has the Company prepared a "simulation" of the deferral calculation for the proposed mechanism? If so, what were the results?

A. Yes. The Company has calculated the deferred revenue amount as described above for the period July 2005 – June 2006. The result was a net deferred revenue amount of $752,000 for the twelve month period. Recovery of this amount over a twelve-month period would result in a rate increase of approximately 0.4% over present rates in effect.

Q. What effect would a 0.4% increase have on the monthly bill for a typical customer, as well as the bill for a low-income customer?

A. A 0.4% increase would increase the monthly bill by 35 cents for a typical customer using 70 therms per month. For 2,500 low-income customers that received LIRAP assistance during the past year, their average usage was 59 therms per month for a recent 12-month period. A 0.4% increase would increase the monthly bill by 29 cents for a customer using 59 therms per month.

<u>Earnings and DSM Tests</u>

Q. Could you please describe the "earnings" and "DSM" tests that you have referred to earlier in your testimony?

A. Yes. The Company would implement a decoupling rate adjustment beginning in the fall of 2007 (coincident with the PGA) only if: 1) it did <u>not</u> "over-earn" for its Washington gas operations during 2006, based on the recent Commission authorized rate of return for Avista of 9.11%, and 2) it meets pre-established gas DSM savings targets during 2006. The authorized rate of return of 9.11% is derived from the Commission's Order No. 05 in Docket No. UG-050483. These tests would be repeated for the subsequent two years, i.e., 2008 surcharge based on earnings and DSM tests for 2007, and 2009 surcharge based on earnings and DSM tests for 2008.

Q. Could you describe the "earnings test" in more detail?

A. Yes. The "earnings-test" would be based on the Company's annual "Commission-basis" operating results, which are currently filed with the Commission by April 30 for the previous calendar year results. If the Commission-basis rate of return for the Company's Washington gas operations exceeds 9.11% for 2006, it would reduce the amount of the proposed surcharge (amount transferred to the balancing account) to bring the rate of return down to 9.11%. If removing the <u>entire</u> deferred revenue amount from the Commission-basis results does not reduce the rate of return to 9.11%, no surcharge would be implemented.

Q. How does the Company propose to treat any deferred revenue balance that cannot be amortized as a result of the earnings test?

A. Where the amount of the surcharge is reduced as a result of the earnings test, the cumulative amount of deferred revenue <u>remaining</u> from the prior year will be carried forward and used to offset future deferrals, rather than written off the Company's books. As shown in the example on Page 1 of Exhibit No. __(BJH-2), if the Company recorded deferred revenue for the February 2007 - June 2007 period of $360,000, but could only surcharge $206,883 for the October 2007 - September 2008 (amortization) period, no <u>additional</u>

deferrals would be recorded beginning in July 2007 until the cumulative balance of new deferrals exceeds $153,117 ($360,000 less $206,883).

Q. Could you please describe the DSM test?

A. Yes. The second "test" regarding implementation of a decoupling surcharge relates to the Company achieving pre-established natural gas DSM target savings during the prior year. The test provides financial incentives to not only meet, but exceed gas DSM goals. The Company's 2006 Integrated Resource Plan (IRP) sets forth a natural gas (Washington & Idaho) target savings level of 1,062,000 therms for calendar years 2006 and 2007. These targets were developed with input from other interested parties through the IRP process, as later discussed by Company Witness Powell. This target savings level will be used for determining the level of the (fall) 2007 and 2008 surcharges; the target savings level included in the Company's 2008 IRP will be used for the 2009 surcharge. Assuming the surcharge level is not reduced based on the "earnings test" described above, the surcharge level could also vary depending on the actual level of gas DSM savings achieved compared to the target levels described above. The following table shows the level of the surcharge (as a percentage of the margin difference between the current year and the test year) based on the actual gas DSM savings compared to the target savings:

<u>Actual vs Target DSM Savings</u>	<u>Surcharge vs Margin Difference</u>
< 70%	0%
70% - 80%	60%
80% - 90%	70%
90% - 100%	80%
> 100%	90% (amount deferred)

Q. Is the table shown above the same as that proposed in the Company's original Petition?

A. No. The table was revised as a result of the discussions with other parties in this proceeding. The table above is the same as that shown in the Company's Amendment(s) to the Petition, dated August 7, 2006. This revised proposal provides an even more rigorous DSM test as compared to the Company's original proposal in the Petition.

Q. Could you provide an example of the DSM test?

A. Yes. Each month, the margin difference between the current month and the corresponding month of the test year is calculated as described earlier, and <u>90%</u> of the difference is recorded as deferred revenue. As an example of the DSM test, let's again assume the total deferred revenue for February - June 2007 is $360,000, which is 90% of the total margin difference ($400,000) for the period. If during 2006, the Company exceeds 100% of the target DSM savings, the Company would file for a decoupling surcharge to recover the total <u>deferred</u> amount of $360,000 beginning in the fall of 2007. If less than 70% of the target savings are achieved, the surcharge amount would be zero. DSM savings achieved between 70% and 100% would result in the corresponding surcharge level shown in the table. Similar to the proposed effect of not meeting the "earnings test", any deferred revenue not recovered as a result of not meeting at least 100% of the DSM target would be carried forward and used to offset future deferrals that would otherwise be recorded. Examples of the surcharge amount under various DSM savings levels are shown on Page 2 of Exhibit No. __(BJH-2).

Q. How would the level of the surcharge be determined using the results of the two tests (earnings and DSM)?

A. The earnings and DSM tests would be calculated independently and the test resulting in the lowest surcharge amount would be used. Examples of potential surcharge levels using both the earnings and DSM savings tests are also shown on Page 2 of Exhibit No. __(BJH-2).

Q. Does the Company file an annual DSM report with the Commission?

A. Yes, it does. The report is filed with the Commission in the spring of each year.

Q. With a financial incentive directly tied to the level of reported DSM savings achieved, is there a need for an additional evaluation of those reported savings?

A. Yes. This issue was raised by other parties in this proceeding and addressed by the Company in the Amendment to its original Petition. The Company proposes to retain an independent third party to audit the results of DSM savings reported for decoupling purposes. The scope of the audit would include an appropriate sampling of projects to verify the work completed, the savings recorded and a review of the engineering estimates used to estimate the savings. The cost of the audit could be funded through DSM tariff rider funds.

Q. Is the Company proposing any changes to its present method of reporting DSM savings?

A. Yes. The Company presently recognizes DSM savings on larger projects as those projects progress and certain milestones are met. This practice is fairly complicated and would be difficult to audit, as many of these projects have phases that may be completed in different calendar years. The Company proposes to change the present method of recognizing DSM savings for decoupling reporting purposes to one where all savings associated with a project are recognized at the time the entire project is completed. This change would substantially reduce the cost of a third party audit and would not affect the 2006 and 2007 (IRP) DSM goal used for decoupling.

Q. You mentioned earlier in your testimony that the Company's DSM target filed in its 2008 IRP would be used for the DSM test related to the level of the surcharge in the final year of the pilot period, beginning in the fall of 2009. Has there been concern expressed by the other parties in this proceeding regarding this proposal?

A. Yes. As the Company's IRP is presently filed with the Commission for "acknowledgement", not approval, other parties have expressed concern regarding their ability to provide input regarding the DSM target in the 2008 IRP. To address this concern, the Company proposes to file its 2008 gas DSM goal as a tariff revision to its decoupling tariff, which would provide a formal process for additional input from all interested parties.

<u>Implementation and Evaluation</u>

Q. You mentioned earlier in your testimony that any annual surcharge related to the Mechanism would be limited to no more than a 2% rate increase. Could you explain this provision in more detail?

A. Yes. After applying the "earnings" and "DSM" tests, the amount of the rate increase resulting from the adjustment would be subject to an annual incremental limit of 2%, i.e., the annual increase in the surcharge cannot exceed a 2% rate increase each year (cumulative of approximately 6% over the pilot term). The incremental surcharge (percentage) increase would be determined by subtracting the annual revenue amount recovered by the present surcharge rate from deferred revenue to be recovered through the proposed surcharge rate, and dividing that net amount by the total "normalized" revenue for Schedules 101 and 111 for the most recent July – June period. Normalized revenue would be determined by multiplying the weather-corrected usage for the period by the present rates in effect. If the incremental surcharge would exceed a 2% rate increase, only a 2% increase would be implemented and any excess deferred revenue would remain in the deferred revenue account and could be recovered the following year, subject to the 2% limitation.

Q. You briefly described the proposed process for filing a decoupling rate adjustment earlier in your testimony. Could you describe the filing and implementation process in more detail?

A. Yes. On or before September 1, 2007, the Company will file a proposed decoupling surcharge (or rebate) based on the amount of deferred revenue recorded for the prior February through June 2007 period. For the (September) 2008 and 2009 filings, the proposed rate adjustment would reflect the total deferred for an entire year (July-June). The results of the "earnings", "DSM" and "2%" tests will be included with the filing and used to determine the amount of the rate adjustment. A proposed tariff will be included in those filings. A sample tariff for the decoupling/conservation rate adjustment is attached for illustrative purposes as Page 3 of Exhibit No. __(BJH-2). The Company presently files its Commission-Basis Earnings report (for the prior year) by April 30th and will file its DSM report in advance of the decoupling filing. The Commission Staff and other interested parties would have ample time to examine and audit these reports prior to the decoupling surcharge filing.

The proposed tariff would reflect a rate adjustment that would recover the deferred revenue amount over a twelve-month period to be implemented coincident with the Company's annual PGA. The surcharge will be a single rate adjustment (same rate) for both Schedules 101 and 111. If the surcharge is approved by the Commission, the deferred revenue amount approved for recovery will be transferred to a balancing account and the surcharge revenue received during the period will reduce the deferred revenue in the balancing account. Any deferred revenue remaining in the balancing account at the end of the year, resulting from over- or under-collection, will be added to the "new" revenue deferrals to determine the amount of the proposed surcharge for the following year.

Q. Could you briefly describe the accounts the Company proposes to use to record amounts related to the Mechanism?

A. The Company is proposing to record the deferred revenue in account 186 – Miscellaneous Deferred Debits. The amount approved for recovery will be transferred into a 182.3 - Regulatory Asset account for amortization via the surcharge revenue received. On the income statement, the Company is proposing to record both the deferred revenue and the amortization of the deferred revenue through Account 407 - Regulatory Debits and Credits, in separate sub-accounts. Pages 4 and 5 of Exhibit No. __(BJH-2) provides additional detail of the specific accounts proposed to be used for the Mechanism and provides example illustrations.

Q. The Company is proposing a pilot term for the Mechanism that would end the monthly deferral calculation in June 2009. Does the Company have a proposed process to extend the Mechanism beyond the pilot term?

A. Yes. On or before March 31, 2009 (three months prior to the end of the deferral term), the Company could file a request to continue the decoupling mechanism beyond the pilot term. That filing would include an evaluation of the Mechanism.

Q. What information would be included in the evaluation of the Mechanism?

A. The Company believes that the details of an evaluation plan should be developed as part of a collaborative process. The Company proposes that during the first year of the Mechanism, the Company, Commission Staff, and other interested parties develop a draft evaluation plan to be presented to the Commission no later than December 31, 2007.

Q. In the Commission's Order No. 04 in Docket UE-050684, the Commission set forth a list of detailed information that PacifiCorp should include in any future decoupling proposal. Are there any items on that list that the Company has not addressed in this filing?

A. No. I believe the Company has addressed all of the items set forth in the Order.

Q. Does that conclude your direct testimony in this proceeding?

A. Yes, it does