BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-08____

DIRECT TESTIMONY OF

WILLIAM G. JOHNSON

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

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

A. My name is William G. Johnson. My business address is 1411 East Mission Avenue, Spokane, Washington, and I am employed by the Company as a Wholesale Marketing Manager in the Energy Resources Department.

Q. What is your educational background?

A. I am a 1981 graduate of the University of Montana with a Bachelor of Arts Degree in Political Science/Economics. I obtained a Master of Arts Degree in Economics from the University of Montana in 1985.

Q. How long have you been employed by the Company and what are your duties as a Wholesale Power Manager?

A. I started working for Avista in April 1990 as a Demand Side Resource Analyst. I joined the Energy Resources Department as a Power Contracts Analyst in June 1996. My primary responsibilities involve power contract origination and management and power supply regulatory issues.

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

A. My testimony will provide an overview of the history of the ERM and provide a summary of the factors contributing to the power cost deferrals during the 2007 calendar year review period. I provide an overview of the documentation the Company has provided in workpapers, which the Company had agreed to provide in the ERM Settlement Stipulation approved and adopted in Docket No. UE-030751. My testimony will also briefly describe how the power cost deferrals are calculated.

Q. Are other witnesses sponsoring testimony on behalf of Avista?

A. Yes. Mr. Ron McKenzie will provide testimony concerning the monthly deferral entries and deferral balance.

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

A. Yes. I am sponsoring Exhibit No.___(WGJ-2), which includes four pages from December 2006's Monthly Power Cost Deferral Report. These pages show the deferral calculations for the period January 2007 through December 2007. Page 1 of Exhibit No.___(WGJ-2) shows the calculation of the deferral, pages 2 and 3 show the actual expenses and revenues, and page 4 shows the retail revenue adjustment.

Detailed workpapers, which are described later in my testimony, have been provided in electronic format to the Commission, and other parties, coincident to this filing.

II. OVERVIEW AND HISTORY OF ERM

Q. Would you please explain the history of the ERM and the annual filing requirement?

A. Yes. The ERM was approved by the Commission's Fifth Supplemental Order in Docket No. UE-011595, dated June 18, 2002, and was implemented on July 1, 2002. That Order approved and adopted a Settlement Stipulation (UE-011595 Stipulation) that explained the mechanism and reporting requirements. Pursuant to the UE-011595 Stipulation, the Company is to make an annual filing on or before April 1st of each year. This filing provides an opportunity for the Commission Staff, and interested parties, to review the prudence of the ERM deferral entries for the prior calendar year. Interested parties are to be provided a 90-day review period, ending June 30th of each year, to review the deferral information. The 90-day review period may be extended by agreement of the parties participating in the review, or by Commission order.

Avista's first Annual ERM Filing covered the six-month period of July 1, 2002 through December 31, 2002. In its Order No. 5, issued February 3, 2004, in Docket No. UE-030751, the Commission approved and adopted a Settlement Stipulation (UE-030751 Stipulation) that resolved the issues related to the first review period and identified specific documentation the Company would file in future ERM annual review proceedings.

Avista has made ERM annual review filings for each subsequent calendar year period. Avista's latest Annual ERM Filing to review deferrals for calendar year 2006 was addressed by the Commission's Order No. 1, dated June 27, 2007 in Docket No. UE-070623. In that order the Commission found that the filing met the requirements of Docket No. UE-011595 and UE-030751, and the power costs deferrals presented were deemed prudent.

Q. What period is covered by this ERM filing?

A. This ERM filing covers the period January 1, 2007 through December 31, 2007.

III. SUMMARY OF DEFERRED POWER SUPPLY COSTS

Q. What were the changes in power costs, the amounts deferred, and the amounts absorbed by the Company during 2007?

A. During 2007 actual net power costs were higher than the authorized net power costs for the Washington jurisdiction by $24,826,407. Of this amount, $16,343,766 was deferred and $8,482,641 was absorbed by the Company. Under the ERM, the first $4.0 million of net power supply costs above or below the authorized level is absorbed by the Company. Fifty percent of the next $6 million and ninety percent of power costs beyond $10.0 million are deferred for the opportunity for later recovery. In addition to the $4 million deadband, the remaining fifty percent from $4 million to $10 million and ten percent of costs beyond $10 million are absorbed by the Company.

Q. Would you please summarize why power supply expense was higher than the authorized level during the review period?

A. Yes. Power supply expense was higher than authorized due primarily to higher retail loads, higher fuel expense and higher net power purchase expense, particularly purchases for power from the Priest Rapids and Wanapum hydroelectric plants.

Retail loads were 77 aMW above the authorized level (authorized is 2004 loads). Because the cost of securing energy to serve that additional load, either through purchasing market electricity or natural gas for generation, is higher than the average cost of production included in base rates, the additional load leads to higher power supply expenses. In the ERM the higher expense of increased loads is partially offset by the retail revenue credit. The retail revenue credit is based on the average cost of production, which is the amount that customers paid in their rate for the energy commodity. Because Avista is still a relatively low cost producer of power, that average production cost, however, is less than the marginal cost of securing additional power supplies to serve growing loads. The difference between the marginal cost of power and the average cost of power included in base rates, coupled with load growth, and the use of a historical test year loads in setting base rates was a primary factor causing power supply expenses to be higher than the authorized level. Beginning January 2008, authorized power supply expense is based on pro forma 2008 loads so the impact on power supply expense from higher loads should be greatly minimized in 2008, since it will be less likely that actual loads will be significantly higher than the pro forma loads that were used to develop authorized power supply expense.

Another major factor increasing power supply expense was fuel cost at Coyote Springs 2, Colstrip and Kettle Falls. All together, the three plants generated only 8.36 aMW less (out of a total of 419 aMW) than was included in the authorized power supply expense. Despite slightly lower generation, however, the fuel expense from these three resources was approximately $13.3 (system), $8.7 million (Washington allocation) higher than the authorized level. The overall impact of higher fuel costs at these three plants was an increase in Washington's allocation of power supply expense of approximately $8.2 million over the authorized level.

Net purchased power costs were also significantly higher than the authorized level, particularly the Company's Mid Columbia purchases from the Priest Rapids and Wampum plants owned and operated by Grant County PUD (Grant). The cost for the Company's share of Wanapum and Priest Rapids was approximately $5 million (Washington allocation) higher in 2007 than in the authorized power supply expense. This is due to unique features of the 2001 power purchase agreement for Priest Rapids and Wanapum that allow Grant to keep more of the financial value of their projects (Priest Rapids and Wanapum) in order to serve load growth in their service territory with project cost power. This means that, as Grant's loads grow, the power we purchase from the project becomes more expensive. Grant had has very high load growth in the last few years, due to very large energy intensive industries locating and expanding in Grant County, and that has resulted in less of the project's value going to the purchasers, including Avista.

Q. Please quantify the factors driving the change in power supply expenses included in the ERM during the 2007 review period.

A. The table below shows the impact on power supply expenses of the three largest factors affecting expenses in 2007 (Washington allocation shown). Slightly favorable hydro conditions decreased expense during 2007. All other factors increased power supply expense, including fuel costs for Coyote Spring 2, Colstrip and Kettle Falls, Mid C costs for Priest Rapids and Wanapum, the cost of serving higher loads, and generally higher market energy prices and higher net power purchase costs. The impact of the primary factors affecting power supply expense during 2007 are shown in the table below.

Factors Contributing to Increased Power Supply Expense 2007 - Washington Allocation	
Decreased Expense Due to Higher Hydro Generation	-$313,710
Increased Expense Due to Higher Fuel Costs for Coyote Springs 2	$5,485,179
Increased Expense Due to Higher Fuel Costs for Colstrip	$659,172
Increased Expense Due to Higher Fuel Costs for Kettle Falls	$2,029,370
Increased Expense Due to Higher Cost for Mid C Generation	$4,956,973
Increased Expense Due to Higher Retail Loads	$7,930,800
Increased Expense Due to Higher Market Prices and Contract Costs	$4,078,623
Total Expenses Above the Authorized Level	$24,826,407

IV. NEW LONG-TERM CONTRACTS ENTERED INTO IN 2007

Q. Please provide a brief description of new long-term contracts that the Company entered into in 2007.

A. The Company entered into two long-term contracts during the 2007 review period. Both contracts were new contracts at updated rates that were otherwise identical to existing contracts. In August 2007, the Company entered into a one-year (October 2007 through

September 2008) capacity exchange agreement that allows the Company to receive power during on-peak hours and return power during off-peak hours. In November 2007, the Company renewed another exchange capacity agreement for calendar year 2008.

Q. Are any of these new contracts subject to the limitation for inclusion in the ERM that was part of the recent ERM settlement?

A. No. The 2006 Settlement Agreement in Docket No. UE-060181 regarding the continuation of the Company's ERM included limitations on cost recovery for new or renewed contracts that are greater than 50 MW and have more than a two year term. Both of the long-term contracts the Company entered into during 2007 had terms of one year.

V. THERMAL RESOURCE AVAILABILITY

Q. Please explain the issue regarding the availability factor for the Company's major thermal plants, specifically Kettle Falls, Colstrip and Coyote Spring 2.

A. The 2006 Settlement Agreement in Docket No. UE-060181 regarding the continuation of the Company's Energy Recovery Mechanism (ERM) included potential limitation of the recovery of fixed costs associated with Kettle Falls, Colstrip and Coyote Springs 2 generating plants when the plants fail to meet a 70% availability factor during the ERM review period

Q. What was the availability of the three thermal plants during 2007?

A. All three plants had availability factors above 70% during the 2007 review period. The availability factors were:

Kettle Falls - 95.64%

Colstrip Unit 3 - 82.1%

Colstrip Unit 4 – 92.7%

Coyote Springs 2 - 80%.

Because all three plants exceeded a 70% availability factor, no further demonstrations regarding recovery of the plants' fixed costs is required.

VI. SUPPORTING DOCUMENTATION

Q. Please provide a brief overview of the documentation provided by the Company in this filing.

A. The Company maintains a number of documents that record relevant factors considered at the time of a transaction. The following is a list of documents that are maintained and that have been provided as part of this filing on a compact disk:

Gas/Electric Transaction Record: These documents record the key details of the price, terms and conditions of a transaction. As part of this filing the Company has provided two confidential worksheets showing each gas and electric term (one month or longer) transaction during 2007, including all key transactions details such as trade date, delivery period, price, volume and counter-party. Also provided is a Heat Rate Summary worksheet that lists the purchases and sales of natural gas and electricity related to fueling Avista's natural gas fired generation. Additional information can be provided, upon request, for any of these transactions.

Position Reports: These daily reports provide a summary of transactions and plant generation. Also included are forward electric and natural gas prices.

Long-Term Physical Electric Load & Resource Tabulation: For transactions with deliveries extending greater than the 18-month period covered by the Position Report, the Company includes this document to show the net average system position during the extended period. This document also shows variability associated with an 80% confidence interval around the combined variability of hydroelectric generation and variability of load.

Forward Market Electric and Natural Gas Price Curves: This daily data is maintained in Nucleus, the Company's electronic energy transaction database record system.

These documents are in addition to the detailed monthly reports, which are filed with the Commission and provided to interested parties, as discussed by Mr. McKenzie.

VII. OVERVIEW OF DEFERRAL CALCULATIONS

Q. Please provide an overview of the deferral calculation methodology.

A. Energy cost deferrals under the ERM are calculated each month by subtracting base net power supply expense from actual net power supply expense to determine the change in net power supply expense. The base levels result from the power supply revenues and expenses approved by the Commission in Docket No. UE-050482. The methodology compares the actual and base amounts each month in FERC accounts 555 (Purchased Power), 501 (Thermal Fuel), 547 (Fuel) and 447 (Sales for Resale) to compute the change in power supply expense. These four FERC accounts comprise the Company's major power supply cost accounts. The ERM also includes changes in Accounts 565 (transmission expense), 456.100 (transmission revenue) and broker fees.

In addition, actual expense for generating plant fuel not burned is included as the net of natural gas sale revenue under Account 456 (revenue) and purchase expense under Account 557.15 (expense) to incorporate the total net change in thermal fuel expense. Also included in

Account 557.15 are other power supply expenses including the purchase and sales of renewable energy credits.

The total change in net expense is multiplied by the Washington allocation of 65.16%. The total power cost change is accumulated until the dead band of $4.0 million is reached. Fifty percent of power cost increases or decreases in between $4.0 million and $10.0 million and ninety percent of the power cost increases or decreases in excess of $10.0 million are recorded as the power cost deferrals and added to the power cost deferral-balancing account.

Q. Please explain how the retail revenue adjustment is determined in the ERM.

A. The ERM includes a retail revenue adjustment to reflect the change in power production and transmission expenses recovered through base retail revenues, related to changes in retail load. The retail revenue adjustment calculation is based on the average cost (fixed and variable) of production and transmission included in the Company's cost of service study filed in the general rate case. These production and transmission costs divided by the annual base (normalized) retail kilowatt-hour sales results in a production related revenue figure of $.03903 per kilowatt-hour.

The monthly retail revenue adjustment in the ERM is computed by multiplying $.03903 per kilowatt-hour times the difference between actual and authorized monthly retail kilowatt-hour sales. If actual kilowatt-hour sales are greater than base, the retail revenue adjustment will result in a credit to the ERM deferral (reduces power supply costs). If actual kilowatt-hour sales are less than base, the retail revenue adjustment will result in a debit to the ERM deferral (increases power supply costs).

Q. What ERM calculations are provided to the Commission and other parties?

A. The Company provides to the parties a monthly power cost deferral report, showing among other things, the calculation of the monthly deferral amount, the actual power supply expenses and revenues for the month and the retail revenue adjustment. These pages from the December 2007 deferral report are included as Exhibit No.____(WGJ-2). The December 2007 deferral report pages show all of the months, January through December of 2007.

Q. Please explain the Potlatch direct assignment credit in the monthly ERM deferral calculation.

A. Consistent with prior ERM filings, the credit on page 1 line 9 of Exhibit No. ____(WGJ-2), labeled "Less Potlatch 62 aMW directly to ID" removes the Potlatch power purchase expense that is included in 555 Purchased Power on page 1 line 1 of Exhibit No. ____(WGJ-2). This credit, which began in July 2003, is a result of the Company entering into a power purchase and sale agreement with Potlatch where the Company purchases up to 62 average megawatts on an annual basis from Potlatch and sells the equivalent amount of power to Potlatch. The expense of this purchase, as well as the revenue from the corresponding sale, is 100 percent allocated to the Idaho jurisdiction. The actual expense is included in Account 555, Purchase Power Expense on page 1, line 1, of the monthly deferral calculations and then removed on page 1, line 9, for the Washington ERM deferral calculation. As a result, no expense related to the purchase of Potlatch generation is included in the Washington ERM deferrals.

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

A. Yes.