BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION d/b/a AVISTA UTILITIES,

Respondent.

DOCKET NOS. UE-090134 & UG-090135 *(consolidated)*

In the Matter of the Petition of

AVISTA CORPORATION, D/B/A AVISTA UTILITIES,

For an Order Authorizing Implementation of a Natural Gas Decoupling Mechanism and to Record Accounting Entries Associated With the Mechanism

DOCKET NO. UG-060518 *(consolidated)*

DIRECT TESTIMONY OF KEVIN D. WOODRUFF (KDW-1T)

ON BEHALF OF

PUBLIC COUNSEL

REVISED (RED-LINED AND SHADED)

SEPTEMBER 2, 2009

DIRECT TESTIMONY OF KEVIN D. WOODRUFF (KDW-1T)
DOCKET NOS. UE-090134 & UG-090134, UG-060518

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KEVIN D. WOODRUFF' EXHIBIT LIST

Exhibit No. ___ (KDW-2)	Kevin D. Woodruff's Resume
Exhibit No. ___ (KDW-3)	Avista's Response to Staff Data Request No. 206
Exhibit No. ___ (KDW-4)	Exhibit No. ___ (RLS-6) – Richard L. Storro (Representing Avista Corporation) Avista Utilities – Lancaster CCCT Power Purchase Agreement Acquisition
Exhibit No. ___ (KDW-5)	Avista *2007 Electric Integrated Resource Plan* (Excerpt)
Exhibit No. ___ (KDW-6)	2009 *IRP Preferred Resource Strategy* Presentation (Excerpt)
Exhibit No. ___ (KDW-7)	Avista *2007 Annual Report* (Excerpt)
Exhibit No. ___ (KDW-8)	Avista's Response to Public Counsel Data Request No. 496

I. INTRODUCTION / SUMMARY

Q: Please state your name and business address.

A: My name is Kevin D. Woodruff. My business address is 1100 K Street, Suite 204, Sacramento, California.

Q: By whom are you employed and in what capacity?

A: I am the Principal of Woodruff Expert Services (WES). I provide expert consulting services to public interest and consumer representatives regarding electric power planning and procurement issues before utility regulatory commissions.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of the Public Counsel Section of the Washington Attorney General's Office (Public Counsel).

Q: Please describe your professional qualifications.

A: I have over twenty years experience in electric utility and power industry analysis and regulation, focused mainly on electric power planning and procurement matters. I formed WES in November, 2002 to provide the services described in lines 6-9 above. Before then, I worked for Henwood Energy Services, Inc. (HESI, now doing business as Ventyx) for over fourteen years providing consulting services and software products to a wide variety of electric industry clients, and another electric power consulting firm for over two years before that. I also had several years of other professional experience before entering the electric power consulting business. I received my A.B. (Bachelor's) degree in Economics from the University of California, Berkeley, in 1976, and a Master of Business Administration degree from the California State University, Sacramento, in 1990. My resume is provided as Exhibit No. ___ (KDW-2).

Q: What exhibits are you sponsoring in this proceeding?

A: I am sponsoring ~~seven~~ eight exhibits, Exhibit Nos. ___ (KDW-1T) through (KDW-~~7~~ 8), including this Direct Testimony and my resume.

Q: What issues are you addressing in your testimony?

A: I am addressing three issues related to Avista's forecast 2010 power supply costs.

- First, I discuss the steps the Washington Utilities and Transportation Commission (Commission) should take given that the Energy Recovery Mechanism (ERM) balance (aka the Energy Cost Deferral Balance (ECDB)[1]) will likely reach zero in the coming months.
- Second, I address in detail Avista's proposal to assign the Lancaster Power Purchase Agreement (PPA) and related electric transmission and gas transportation contracts (Lancaster Contracts or Contracts) to Avista Utilities.
- Finally, I also comment on the natural gas prices that should be used to set Avista's 2010 power supply costs.

Q: Please summarize your recommendation regarding the reduction of the Schedule 93 surcharge.

A: It is important that the reduction of this surcharge is not considered as a component of the overall revenue request. The timing of this reduction is coincident to the Company's general rate case, but the two are unrelated.

[1] Avista refers to the ERM balance in *its* testimony in this case. See, for example, Exhibit No. ___ (BJH-1T), p. 6, ll. 4-8. The Settlement Stipulation establishing the ERM referred to the ECDB. See Fifth Supplemental Order, Docket No. UE-011595, Appendix B, Section 4.e., at p. 7. I have occasion to refer specifically to the ECDB below.

Q: What actions should the Commission take with regard to Avista's proposal to assign the Lancaster Contracts to Avista Utilities?

A: With regard to Avista's proposal to assign the Lancaster Contracts to Avista Utilities, the Commission should (1) find that Avista has not complied with several Commission requirements regarding the procurement of generating resources, particularly the need to seek competitive bids via a Request for Proposals (RFP), and (2) reject the assignment of each of the Lancaster Contracts for calendar year 2010. The Commission would also be fully justified to reject the assignment of the Lancaster Contracts for all years after 2010 as well. However, should the Commission determine that the Lancaster Contracts likely offer long-term benefits to Avista Utilities' ratepayers, the Commission should only allow Avista Corp. to assign to Avista Utilities the Lancaster PPA itself and eighty percent of the capacity of the gas transportation contracts starting in 2011.

Q: What actions should the Commission take regarding the gas prices used to set Avista's 2010 revenue requirements?

A: The Commission should adopt a gas price forecast for setting Avista's 2010 power supply costs in this case that will be as current as reasonably possible as of January 1, 2010, provided that the Commission and parties have an opportunity to review and assess such updated data and power supply cost estimate, and subject to any legal limits on increasing revenues beyond those reflected in the proposed tariffs filed with the Commission.

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Q: Should your testimony be read as addressing any other aspects of Avista's filing in this docket?

A: No. My silence about other aspects of Avista's filing, or specific aspects of Avista's filing regarding the above topics, should not be taken as either endorsement or criticism of Avista's positions.

II. REDUCTION OF SCHEDULE 93 SURCHARGE

Q: How should the Commission view the projected reduction of the ERM balance (or ECDB) to zero?

A: Avista reported recently that it expects the ERM deferral balance to fall to $4.8 million by the end of 2009, which suggests the balance would likely fall all the way to zero in early 2010.[2] In its testimony in this docket, Avista has proposed to reduce to zero at the end of the year the Schedule 93 surcharge rate designed to recover these amounts, regardless of the actual remaining ERM balance – though Avista would still refund or recover, as appropriate, any balance remaining at the end of this year.[3] The Commission – and for that matter, all parties – should welcome the surcharge reduction as closing the book on a sad chapter in Western power markets and regulation.

However, the Commission should keep in mind that the reduction of the ERM balance is the result of a significant rate surcharge – that is, a charge that allows Avista to recover substantially more in revenues than its ongoing costs of

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[2] Avista's Monthly Power Cost Deferral Report, June 2009, submitted dated July 14, 2009 in Docket No. UE-011595.
[3] Exhibit No. ___ (BJH-1T), p. 6, ll. 4-11.

service – that Avista has been allowed to impose on its electric ratepayers for nearly eight years.

In estimating Avista's requested changes to its 2010 revenue requirements as filed in this docket, it is important that the elimination of this surcharge is not considered as a component of the overall revenue request. That is, the Commission should consider any changes to Avista's 2010 rates to be relative to a view of Avista's 2009 rates *without the Schedule 93 surcharge.* Avista suggests in its testimony that the ERM reduction will act as an offset to the total increase that the Company has requested. For example, in his direct testimony, Avista CEO Scott Morris portrays the requested increase largely in terms of a "net increase" in its *rates.*[4] While technically true, describing Avista's request as a "net increase" of 8.6 percent masks Avista's requested increase in its 2010 *costs of service,* which – at 16.0 percent – is much higher.[5]

III. LANCASTER CONTRACTS

A. Summary of Lancaster Contracts

Q: What is the relationship between the Lancaster Contracts and the Avista Corporation (Avista Corp)?

A. As described more fully below, the Lancaster Contracts are now the responsibility of Avista Corp. shareholders. In this docket, Avista is proposing to assign responsibility for these Contracts to the ratepayers of Avista Utilities.

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[4] Direct Testimony of Scott L. Morris, Exhibit No. ___ (SLM-1T), p. 3.
[5] Exhibit No. ___ (BJH-1T), p. 3, l. 12.

Q: What specific transactions has Avista proposed to transfer or assign to Avista Utilities?

A: In brief, Avista is proposing to assign to Avista Utilities three specific sets of contracts effective January 1, 2010.[6] These contracts are (1) the Lancaster PPA itself, which provides the assignee the rights to operate the 275 MW Lancaster Combined Cycle power plant (Plant) in northern Idaho through October 2026, (2) a transmission contract with the Bonneville Power Administration (BPA) that provides 250 MW of firm transmission between the Plant and the John Day point of delivery through June 2026, and (3) gas transportation contracts with Gas Transmission Northwest (GTN) and TransCanada that together provide rights to firm transportation of up to 26,000 Decatherms/day (Dth/d) from Alberta and an additional 26,000 Dth/d from either the Stanfield or Malin trading hubs through October, 2017.[7] As stated above, these contracts taken together are herein referred to as the Lancaster Contracts or Contracts.

Under Avista's proposal, Avista Utilities would be obligated to pay all the Contracts' fixed costs, but would also gain all the benefits that would accrue from controlling the Contracts.

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[6] In recent *Annual Reports*, Avista has used the word "transfer" to describe its proposal to shift cost responsibility from Avista Corp. shareholders to Avista Utilities' ratepayers. For example, see Exhibit No. ___ (KDW-7), p. 15, which is an excerpt from Avista's *2007 Annual Report*. The word "transfer" is used consistently regarding Avista's proposal in both Avista's *2007 Annual Report* and *2008 Annual Report*. I use the term "assign" in this testimony.

[7] Exhibit No. ___ (RLS-1T), p. 9, l. 20 to p. 11, l. 3, and Exhibit No. ___ (RLS-5), pp. 7-11 of 31. This latter source listed the Plant's capacity as 262 MW (p. 7).

Q: If the Commission did not approve the proposed assignment of the Contracts, what entities would be responsible for paying the Contracts' costs and receive the Contracts' benefits?

A: Other unregulated subsidiaries of Avista Corp. – that is, shareholders – would be responsible for paying the fixed costs of each contract, since Avista Turbine Power would retain the rights and obligations of the Lancaster PPA.[8] It is not clear to me whether Avista Turbine Power or Avista Energy would retain the rights and obligations to the electric transmission and gas transportation contracts, but such rights and obligations would clearly remain with Avista's unregulated subsidiaries. These Avista Corp. subsidiaries would also gain any benefits that control of these contracts would yield.

Q: Should the Commission view Avista's proposed assignment of the Contracts to Avista Utilities as an "affiliate transaction"?

A: Yes. The proposed assignment of contracts that are the responsibility of Avista Corp's unregulated subsidiaries to Avista Utilities should clearly be considered an "affiliate transaction."

Q: What is the amount of fixed costs that Avista is proposing to assign to Avista Utilities' ratepayers?

A: Based on my interpretation of a consultant's analysis of the Contracts' value that Avista Utilities commissioned and Avista's Response to Public Counsel Data Request No. 227, Avista's proposal would transfer from unregulated Avista Corp. subsidiaries to Avista Utilities over $30 million per year in fixed costs from 2010

[8] Avista's Responses to Public Counsel Data Request Nos. 97(a) and 131.

through 2026; these estimated annual costs for 2010 to 2015 are shown in Table 1 below.[9,10] This is a very significant shift of fixed cost responsibility from Avista Corp. shareholders to Avista Utilities' ratepayers. Avista's proposal thus merits the Commission's close attention – and should have merited a better analysis and justification from Avista. Further, Avista failed to meet the Commission's requirements regarding utility resource procurement.

Table 1. Annual Fixed Costs of Lancaster Contracts from 2010-2015
(in millions)

Fixed Cost Component	2010	2011	2012	2013	2014	2015
Operations & Maintenance	$5.4	$5.5	$5.6	$5.8	$5.9	$6.1
Capacity	$15.1	$15.3	$15.4	$15.6	$15.7	$15.9
Transmission	$4.7	$4.8	$4.9	$5.0	$5.2	5.3
Gas Transportation	$4.3	$4.8	$4.9	$5.0	$5.2	5.3
Total	**$31.4**	**$31.9**	**$32.3**	**$32.8**	**$33.3**	**$33.8**

Notes:
- All Data from Exhibit No.__ (RLS-5), Appendix C, p. 1 (page 28 of 31).
- Transmission multiplied by 4 to produce BPA fixed costs (page 9 of 31).
- Gas Transportation expenses assumed to end 10/31/17 to reflect end of fixed charges of current contract (pages 7-8 of 31).
- Gas Transportation divided by 0.8 (multiplied by 1.25) to reflect TL's exclusion of such costs from analysis (page 8 of 31).
- Use of data verified by Avista Response to Public Counsel Data Request No. 227.

B. <u>Key Regulatory Policies</u>

Q: What are the key regulatory policies the Commission must consider in assessing Avista's proposed assignment of the Lancaster Contracts to Avista Utilities?

[9] Exhibit No. ___ (RLS-5) at p. 28. Consistent with Avista's testimony regarding the benefits and costs of the Lancaster Contracts, the data shown in Table 1 and the following tables and analysis are presented on an Avista "System" basis, that is, including the benefits and costs to Avista customers in *both* Washington and Idaho. In Sections IV and V, I provide specific recommendations regarding adjustments to Avista's Washington revenue requirements that reflect the Washington allocation factor of 64.59 percent.

[10] The estimated 2010 costs of Lancaster Contracts shown in Table 1 differ from those shown in Table 2 below. The data shown in Table 1 were based on a long-term forecast of fixed costs, while the data shown in Table 2 were based on Avista's detailed estimate of 2010 revenue requirement and also included variable costs.

A: There are two key policies the Commission must keep in mind: (1) standards of "prudence" regarding utility resource acquisitions in general, and (2) the more stringent standards that specifically govern utility affiliate transactions, including Avista's prior stipulation to avoid such transactions as long as its ECDB was greater than zero.

1. Prudence Requirements

Q: What are the Commission's prudence standards that apply to the assignment of the Lancaster Contracts?

A: As Avista has noted, the Commission's basic prudence standards were promulgated in the Eleventh Supplemental Order and the Nineteenth Supplemental Order in Docket No. UE-920433.[11] However, in more than one way, Avista has failed to make a showing that its proposed assignment of the Lancaster Contracts to Avista Utilities complies with all these criteria.

First, Avista makes the claim that the finding of a need for Combined Cycle Combustion Turbine (CCCT) capacity in its *2007 Integrated Resource Plan* (*2007 IRP*) somehow validates the proposed assignment of the Lancaster Contracts.[12] However, the Commission's policy is clear that the presence of a type of resource in a utility's IRP does not *ipso facto* mean that a specific proposed resource is reasonable. For example, the Nineteenth Supplemental Order the Commission quoted from the Eleventh Supplemental Order as follows:

> Although a least-cost plan may contain information helpful in determining the prudence of resource selection, this is only one consideration in the evaluation. Additional information is required to

[11] Exhibit No. ___ (RLS-6), p. 1, and Avista's Response to Public Counsel Data Request No. 132.
[12] Exhibit No. ___ (RLS-1T), p. 11, ll. 4-14 and p. 16, l. 13 to p. 17, l. 2.

> prove prudence, as indicated in the least-cost planning rule itself. The Commission's acceptance of a company's least-cost plan does not represent a finding of prudence of a particular resource. The least-cost planning process is not sufficiently rigorous or specific to support an independent finding of prudence.[13]

Further, Avista made no credible effort to assess "what other purchases are available"[14] in the market that could provide similar value, but only hypothesized what such purchases might be. Moreover, Avista did not issue any RFP in attempting to fill the need identified in the *2007 IRP*.[15]

2. Affiliate Transaction Requirements

Q: What are the Commission's standards governing affiliate transactions that are relevant to the assignment of the Lancaster Contracts?

A: Despite the fact that the proposed assignment of the Lancaster Contracts to Avista Utilities would be an affiliate transaction, Avista did not cite affiliate transaction rules as applying to its proposal. Still, these Commission rules must be respected in considering Avista's proposal in this case.

First, it is useful to recount the Commission's statements regarding affiliate transactions. For example, the Commission has stated:

> The purpose of the affiliated interest statute is to protect ratepayers from cross-subsidization by regulated companies of unregulated affiliates. Because a regulated utility and an affiliate do not engage in arms' length bargaining with each other, the regulated utility has the burden to demonstrate that its transactions with an affiliate are reasonable.[16]

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[13] Nineteenth Supplemental Order in Docket No. UE-920433, p. 12.
[14] *Id.*, p. 11.
[15] Avista's Response to Public Counsel Data Request No. 87.
[16] Sixth Supplemental Order in Docket No. UG-021584, p. 9, ¶ 24.

As stated above, Avista made no showing that the proposed assignment of the Lancaster Contracts met the basic prudence standard.

Q: Has Avista made any commitments to avoid affiliate transactions such as the assignment of the Lancaster Contracts?

A: Yes. In the Settlement Stipulation establishing the Energy Recovery Mechanism (ERM), Avista agreed that:

> The Company agrees that it will not enter into electric or natural gas commodity transactions with Avista Energy related to Avista Utilities' electric operations until the Energy Cost Deferral Balance carries a net credit balance. This provision does not preclude transactions between the two companies related to Avista Utilities' natural gas distribution business.[17]

Avista had this commitment, made in 2002, clearly in mind in June, 2007 when it reiterated this agreement in Avista's Response to Staff Data Request No. 206 in Docket Nos. UE-070804 and UG-070805, which is attached to my testimony as Exhibit No. ___ (KDW-3). Yet earlier in 2007, Avista saw no bar to assigning the Lancaster Contracts from its unregulated affiliates to Avista Utilities as of January 1, 2010.

Based on this commitment, until the ECDB falls to zero, Avista should not make any such contract assignment to Avista Utilities unless it has received agreement from all the settling parties to modify the above Settlement Stipulation. I understand that no such modification agreement has been reached.

Q: Are any other aspects of the Commission's policies regarding affiliate transactions relevant to the proposed assignment of the Lancaster Contracts?

[17] Fifth Supplemental Order, Docket No. UE-011595, Appendix B, Section 4.e., at p. 7.

A. Yes. The Commission's affiliate transaction standards may also pose a higher barrier to such transactions than "mere" prudence: that the test of reasonableness is based on the "lower of cost or market" standard.[18] In other words, an affiliate cannot merely offer a "market" deal to the utility if the affiliate's costs are lower; instead, utility customers are entitled to services at the affiliate's "cost" if such costs are less than market.

Q: Does Avista's proposed assignment of the Lancaster Contracts violate any other Commission policies regarding utility procurement?

A. Yes. The Commission has adopted requirements, per chapter 480-107-001 to 480-107-999 of the Washington Administrative Code (WAC), that utilities engage in RFP processes to procure power from non-utility generators. Avista's failure to issue an RFP to meet the need identified in its 2007 IRP appears to violate this policy as well.

C. Assignment of Contracts in 2010 Should Be Rejected

Q: What actions should the Commission take regarding Avista's request to assign the Lancaster Contracts to Avista Utilities in 2010?

A: The Commission should reject assignment of any of the Lancaster Contracts to Avista Utilities in 2010.

Q: Why do you address the year 2010 separately from the later years of the Lancaster Contracts' duration?

A: As discussed below, it is not clear that the Lancaster Contracts will provide positive net value to Avista Utilities' ratepayers in any year from 2010 to 2026. However,

[18] Sixth Supplemental Order in Docket No. UG-021584, p. 13, ¶ 32.

Avista's rationale for assigning the Contracts to Avista Utilities is especially weak for the year 2010 in particular.

Q: What does Avista say regarding the need for the Lancaster Contracts in general, and in 2010?

A: As stated above, Avista generally contends that the finding, per the *2007 IRP,* that Avista Utilities needs CCCT capacity to meet forthcoming short positions for both energy and capacity. Avista then argues that the Lancaster Contracts fill that need cost-effectively.[19]

Q: Why is this argument inadequate to support Avista's proposal to assign the Lancaster Contracts to Avista Utilities in 2010 in particular?

A: First, as noted above, the mere fact that an IRP shows a need for a CCCT is not adequate to justify any particular CCCT. More importantly, when it made the decision to assign the Lancaster Contracts, Avista *was not forecasting any need for CCCT capacity in 2010*. Rather, Avista was forecasting that it would not have such a need until 2011.

For example, Mr. Richard L. Storro's Direct Testimony presented what is apparently Avista's final summary of its analyses of the Lancaster Contracts as Exhibit No. ___ (RLS-6). That exhibit, prepared in early 2007, presented three separate resource need tables which show Avista has adequate annual energy and capacity resources through 2010, and no need until 2011.[20] These tables are provided in Exhibit No. ___ (KDW-4). Tables 1 and 2 from Avista's *2007 IRP* also

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[19] Exhibit No. ___ (RLS-1T), p. 11, ll. 4-14 and p. 16, l. 13 to p. 17, l. 2.
[20] Exhibit No. ___ (RLS-6), p. 3, Tables 1, 2 and 3.

document Avista's balanced position through 2010.[21] These tables are provided as Exhibit No. ___ (KDW-5).

Further, more recent Avista data suggest the Lancaster Contracts are excess to Avista's 2010 electric needs. For example, a load-resource summary from a June 24, 2009, Technical Advisory Committee Meeting on Avista's 2009 Electric IRP suggests Avista has approximately 300 MW more capacity than it needs – that is, that the Plant's 275 MW of capacity is not necessary to meet its reserve margin targets in 2010. This chart is provided as Exhibit No. ___ (KDW-6).

Q: Did Avista contend in this case that it needed a CCCT to meet quarterly energy short positions in 2010?

A: Yes. Avista witness Richard L. Storro made such a claim his Direct Testimony.[22] In Avista's Response to Public Counsel Data Requests, Avista also said in April that – without the Lancaster Contracts – it had energy needs of 16 and 51 average Megawatts (aMW) in the first quarter and fourth quarter of 2010, respectively, but has energy surpluses in both the second and third quarters[23] and capacity surpluses in all quarters of 2010.[24]

But such short-term energy needs can be met by alternate, likely lower-cost means – such as the type of short-term market purchases that Avista routinely makes – than buying the Plant's entire 275 MW of capacity. And as stated above, in the *2007 IRP* Avista did not conclude that it needed new CCCT capacity in 2010 – it concluded that it needed such new capacity in 2011. Avista's argument that the

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[21] Avista's *2007 IRP* was provided as Exhibit No. ___ (RLS-2); see pp. i and vi for Tables 1 and 2.
[22] Exhibit No. ___ (RLS-1T), p. 11, ll. 9-11.
[23] Avista's Response to Public Counsel Data Request No. 88.
[24] Avista's Response to Public Counsel Data Request No. 89.

Lancaster Contracts are needed to meet Avista Utilities' needs in 2010 is thus not valid and should be rejected by the Commission.

Q: Would the assignment of the Lancaster Contracts raise Avista Utilities' rates in 2010?

A: Yes. Based on the dated analysis in Avista's original filing, the Lancaster Contracts would raise rates by $16.6 million in 2010.[25] Further, according to a new forecast of 2010 power supply costs based on recent gas prices, 2010 rates would increase by $18.3 million.[26] These impacts are illustrated on Table 2 below.

Table 2. Avista Estimates of Impact of Lancaster Contracts on 2010 Power Costs

	Gas Price Date	
	30-Nov-08	**05-Aug-09**
AECO gas price	$7.48/MMBtu	$5.36/MMBtu
Benefits Costs	$18.1M ($34.7M)	$17.0M ($35.3M)
Net Benefit	**($16.6M)**	**($18.3M)**

Sources: Avista Response to Public Counsel Data Request Nos. 81 and 496.

Q: Is there other evidence that the assignment of the Lancaster Contracts would raise Avista Utilities' costs?

A: Yes. Avista has noted publicly that the Lancaster Contracts have been money-losers for its unregulated operations. Specifically, in its *2007 Annual Report*, Avista noted it had suffered "losses on the power purchase agreement for the Lancaster Plant." This statement is found at the bottom of page 14 of the Avista Corporation's *2007*

[25] Avista's Response to Public Counsel Data Request No. 81. Avista witness Johnson reported, in Exhibit No. ___ (WGJ-1T), p. 5, lines 4-7, that $10.7 million of this increase would be allocated to Washington ratepayers.
[26] Avista's Response to Public Counsel Data Request No. 496.

Annual Report; this portion of the *2007 Annual Report* has been attached to my testimony as Exhibit No. ___ (KDW-7). Avista Utilities' ratepayers will face the risks of such losses if all the Lancaster Contracts are assigned to it as proposed in this case.

Q: Has Avista met its burden of proof that the Lancaster Contracts would provide benefits to customers in 2010?

A: No. Avista has not shown Avista Utilities needs the Lancaster Contracts to meet any capacity or energy needs in 2010. Further, evidence suggests the Lancaster Contracts would raise Avista Utilities costs in 2010. There is no reason for Avista Utilities' customers to pay higher rates for resources that are not needed.

D. Avista Has Not Met Prudence Criteria For Any Year

Q: Does Avista have a need for new CCCT capacity after 2010?

A: Yes, according to Avista projections. As noted above, according to its *2007 IRP*, Avista's needs after 2010 would be best met by CCCT capacity, such as the capacity that would be provided by the Lancaster Contracts.

Q: Does this IRP finding necessarily mean that the assignment of the Lancaster Contracts is the best means for filling this need?

A: No. As also noted earlier, such an assignment must still meet the basic "prudence" standards applied to utility procurement in general and to affiliate transactions in particular. In addition, until the ECDB falls to zero, Avista cannot assign the Contracts to Avista Utilities until it receives permission from all parties to the Settlement Stipulation, as discussed above.

Q: What specific tests of prudence have not been met?

A: The key omission is that Avista has not made a credible effort to determine "what other purchases [were] available," as also noted above. Without such a "market test," the Commission cannot safely conclude that the assignment of the Lancaster Contracts to Avista Utilities is the best possible means for meeting the long-term resource needs identified in Avista's *2007 IRP*.

Q: Do you find convincing Avista's analyses suggesting that the Lancaster Contracts will provide value to Avista Utilities' ratepayers?

A: No. First, no such study is a replacement for an assessment of "what other purchases are available," such as would be provided by an RFP. But even if one did consider studies as being valid measures of the availability of other PPAs, the analyses Avista provided in its testimony do not persuade me that the Lancaster Contracts offer value to Avista Utilities' ratepayers. I will discuss this issue in more detail below.

E. Avista Analyses of Lancaster Value Flawed

Q: Has Avista shown that the Lancaster Contracts would provide value to Avista Utilities' ratepayers?

A: No. I am skeptical of the validity of the analyses Avista has submitted purporting to show that the Lancaster Contracts provide value. These studies do not provide the Commission a sound basis for concluding that it should allow Avista to assign the Contracts to Avista Utilities.

Q: What analyses has Avista submitted to support the argument that the Contracts would provide value to ratepayers?

A. Avista has put forward two major types of analyses. The first set of analyses compares the costs of the Lancaster Contracts to other real and hypothetical "alternatives" or "comparables," that is, other potential CCCT projects that might provide electric capacity and energy to Avista Utilities.[27] Data regarding such comparables were generally developed based on review of public information regarding recent transactions and construction projects in the Pacific Northwest.

The second major type of study was Discounted Cash Flow (DCF) analysis. TL prepared such analyses, evidently to estimate the value of the Contracts' cash flows.[28]

1. "Comparables" Analyses

Q: What are your concerns with Avista's and TL's analysis of "comparables" to the Contracts?

A: I have two chief concerns with the analyses of comparable projects that Avista has submitted.

First, as discussed above, Avista's analyses of comparables – which identifies the Contracts as being lower cost than other "comparables" – implicitly assumed that Avista Utilities had a *need* to procure the capacity and energy rights from a CCCT. If the need assumption is not valid, then analyses showing the Contracts are the least cost means of meeting such a need are irrelevant. As noted above, Avista does not need combined cycle capacity in 2010. Therefore, the comparables analysis does not

[27] Avista's internal comparables analyses are presented primarily in a document titled "Lancaster Generating Facility Power Purchase Agreement Evaluation Overview" (Exhibit No. ___ (RLS-4)). The comparables analyses performed by an outside consultant, Thorndike Landing (TL), were provided in a document titled "Independent Valuation of Lancaster Facility Tolling Agreement" (Exhibit No. ___ (RLS-5)). These analyses are also referenced in Mr. Storro's Direct Testimony (Exhibit No. ___ (RLS-1T)) and a document titled "Avista Utilities – Lancaster CCCT Power Purchase Agreement Acquisition" (Exhibit No. ___ (RLS-6)). Avista's studies were prepared in early 2007 when Avista management was considering whether to assign the Lancaster Contracts to Avista Utilities; TL's analyses were prepared later in 2007, after Avista had already decided to assign the Lancaster Contracts to Avista Utilities.
[28] TL's analyses were also presented in Exhibit No. ___ (RLS-5) and also referenced in Exhibit No. ___ (RLS-1T) and Exhibit No. ___ (RLS-6).

provide useful information regarding whether the Commission should allow Avista to assign the Lancaster Contracts to Avista Utilities in 2010.

Second, though they were based on public data, the comparable analyses were still largely *hypothetical* estimates of the cost of CCCT capacity to Avista Utilities – not based on an actual market test, which would determine whether CCCT capacity could be procured on terms and conditions better than or equal to those of the Lancaster Contracts. Avista confirmed that it did not conduct such an RFP process regarding the CCCT need identified in its 2007 IRP – nor any RFP for conventional gas-fired generation within the last five years.[29]

The Company further stated "Avista did not solicit proposals for a PPA as part of the internal analysis."[30]

Avista also acknowledged:

> [T]he Company was not aware of and could not locate any publicly available data regarding the terms and recent long-term power purchase agreements from CCCT plants.[31]

Avista's internal analyses of comparables to the Lancaster Contracts were thus flawed by a lack of real data about the opportunities available in 2007 to enter a long-term PPA for CCCT capacity.

TL also compared the Lancaster Contracts to real and hypothetical comparables. Like Avista, TL used some publicly available market data regarding regional CCCTs, but did not compare the Contracts to actual competitive offers for CCCT capacity and energy. Avista acknowledged that TL's analysis:

[29] Avista's Response to Public Counsel Data Request No. 87.
[30] Avista's Response to Public Counsel Data Request No. 173.
[31] Avista's Response to Public Counsel Data Request No. 103.

> [D]id not include an assessment of the availability of tolling contracts or other power purchase agreements from such projects as identified in the Thorndike Landing report. [32]

Avista's and TL's analyses of comparables are thus not persuasive that the Lancaster Contracts are the best alternative to obtain CCCT capacity for Avista Utilities. Rather, as noted above, Avista's failure to assess what might have been available in the market violates the Commission prudence standards that Avista cited in its own testimony. This specific criticism of Avista's analysis is valid not just for 2010, but for all years of the Contracts' duration.

2. DCF Analyses

Q: What are your concerns with TL's DCF analyses of the value of the Lancaster Contracts?

A: I have several questions regarding TL's general methods and results. In this testimony, I want to highlight two specific concerns for the Commission. These are (1) the divergence between TL's estimate of the Contracts' cash flows in 2010 and Avista's estimate of the net cost of the Contracts in 2010, and (2) the significant reduction in the Contracts' value wrought by current gas prices.

Q: What is the divergence between TL's estimate of the Contracts' cash flows in 2010 and Avista's estimate of the net cost of the Contracts in 2010?

A. TL estimates that the Lancaster Contracts will yield "Earnings Before Interest, Taxes, Depreciation and Amortization" (EBITDA) of $5.8 million in 2010. That is, the Contracts will provide *positive* cash flows in 2010 before taxes and non-cash

[32] Avista's Response to Public Counsel Data Request No. 127.

charges against earnings.[33] However, as noted in Table 2 above, in its original filing, Avista projected the Contracts would have a *net cost* of $16.6 million in 2010 – an outcome $22.4 million more costly for Avista Utilities' ratepayers than TL's estimates of EBITDA.

Q: What do you believe are the differences between TL's and Avista's estimates of the 2010 cost impact of the Lancaster Contracts?

A: There are undoubtedly numerous differences in assumptions between Avista's and TL's estimates. However, three components in particular may explain much of the difference. These are different assumptions about (1) "capacity revenues," (2) electric transmission contract cost recovery, and (3) gas transportation contract cost recovery.

Q: What are the different capacity revenue assumptions?

A: TL assumes that Avista Utilities will benefit from $17.1 million in "capacity revenues" in 2010 if the Lancaster Contracts are assigned to them.[34] I cannot find any comparable benefit of the Lancaster Contracts in Avista's forecast of its revenue requirements.

Q: What are the different electric transmission cost recovery assumptions?

A. TL assumes that Avista Utilities will benefit from re-marketing three-fourths of the electric transmission capacity available under the BPA contract, or $3.5 million.[35]

[33] Exhibit No. ___ (RLS-5), p. 28 of 31.
[34] *Id.*
[35] Exhibit No. ___ (RLS-5), p. 9 of 31.

Avista's proposed 2010 revenue requirements assume they will recover no such costs, as stated in its response to Public Counsel's Data Request No. 237:[36]

> No revenue from the resale of BPA transmission from the Lancaster plant will be assigned to Avista January, 1, 2010 is included in the rate case.

Q: What are the different gas transportation cost recovery assumptions?

A: TL further assumes that Avista Utilities will re-market one-fifth of the gas transportation capacity available from various contracts, or about $0.9 million.[37] Avista's proposed 2010 revenue requirement does not appear to assume that any such costs are recovered.

Q: What is the sum of these differences?

A: These differences sum to $21.5 million, which is the bulk of the $22.4 difference between the Avista and TL estimates of Contracts-related cash flows. These differences are summed in Table 3 below.

Table 3. Costs Thorndike Landing assumes are recovered in 2010 that are not included in 2010 Revenue Requirement request.	
(in millions)	
Capacity Revenue	$17.1
Transmission Remarketing	$3.5
Gas Transportation Remarketing	$0.9
Total	**$21.5**

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[36] Avista's Response to Public Counsel Data Request No. 237.
[37] Exhibit No. ___ (RLS-5), p. 8 of 31.

Q: What is the implication of these differences between TL's and Avista's estimates of 2010 cash flows that would accrue to Avista Utilities under the Lancaster Contracts?

A. The $21.5-million-plus gap between TL's estimated 2010 Contracts-related cash flows and Avista's 2010 estimated Contracts-related revenue requirements request raises serious doubts as to the assumptions underlying TL's valuation of the Contracts. At a minimum, this finding further supports the above argument that the Commission should not allow assignment of the Contracts for the year 2010.

Q: What are your concerns with the impact of gas price sensitivities on the results of TL's model?

A: In addition to its Base Case, which was cited above, TL prepared "High" and "Low" estimates of the value of the Lancaster Contracts. TL estimated the "High Case" based on assumed higher future CO2 costs and based its "Low Case" on an assumption of a major overbuild of CCCT capacity in the Western Electricity Coordinating Council (WECC). TL developed the Low Case on the assumption that the "spark spread compression" that would occur under such an overbuild and was the major danger to the value of the Contracts.[38] Avista agreed with TL's construction of these scenarios.[39]

However, I believe changes in forecast gas prices may be the greatest single driver of changes in the estimated value of the Lancaster Contracts.

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[38] Avista's Response to Public Counsel Data Request No. 123(a).
[39] Avista's Response to Public Counsel Data Request No. 123(b).

Q: Do you agree that projecting an overbuild sensitivity is the best way to develop a "Low Case"?

A: Not necessarily. TL's Low Case appears to provide some useful information regarding one threat to the long-term value of the Contracts. However, it is also well-established that, when assessing the value of gas resources in regions with market prices that vary largely with gas prices, all else being equal, gas resources offer higher value when gas prices are high and lower value when gas prices are low. This result occurs because the "dollars per Megawatt-hours" ($/MWh) difference between such resources' costs and market prices rises as gas prices rise, and falls when gas prices fall. This phenomenon is especially true for low heat-rate resources such as CCCTs, which offer large $/MWh savings and operate at higher capacity factors than less efficient peaking units. Table 4 below illustrates the impact of changing gas prices on the $/MWh benefit of a CCCT such as the Lancaster Plant. As gas prices fall from $10.00 to $4.00 per million British thermal unit (MMBtu), the benefit falls linearly, from $15.00 to $6.00 per MWh.

Table 4. Impact of Gas Prices on Value of CCCTs

	Gas Prices ($/MMBtu)		
	$4.00	**$7.00**	**$10.00**
Market:			
• Implied Heat Rate (MMBtu/MWh)	8.5	8.5	8.5
• Market Price ($/MWh)	$34.00	$59.50	$85.00
Combined Cycle:			
• Plant Heat Rate (MMBtu/MWh)	7.0	7.0	7.0
• Cost ($/MWh)	$28.00	$49.00	$70.00
Benefit of Combined Cycle	**$6.00**	**$10.50**	**$15.00**

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Q: Do Avista and TL agree that gas price sensitivities are as important as you think they are?

A. Apparently not, given their responses to data requests on these issues. For example, Avista said it "does not believe the Lancaster PPA's value would substantially vary as gas prices vary" and that TL's high and low cases are reasonable.[40]

TL said instead that "spark spread compression" could also occur "in years of low fuel prices," but considers low gas prices "too short term in nature to drive a long term PPA decision."[41]

Q: Do you agree with TL's contention that "years of low fuel prices" are too "short term in nature to drive a long term PPA decision"?

A. No. Gas prices are certainly variable in the short-term, but their long-term trajectory is also highly uncertain. Assessments of the Contracts' value in the presence of high and low gas prices might yield more robust assessments of the potential bounds of the Contracts' value.

Q. Do you have any evidence to offer about the impact of gas prices on the estimated value of the Lancaster Contracts?

A: Yes. Pursuant to Public Counsel Data Request No. 238, TL re-estimated the value of the Contracts assuming that gas prices were exactly $1.00/MMBtu less in every year than the gas prices they used in their original analysis, while holding all other inputs constant. This reduced the average AECO gas price in 2010 from $7.16/MMBtu to

[40] Avista's Responses to Public Counsel Data Request Nos. 123(b) and 123(d).
[41] Avista's Response to Public Counsel Data Request No. 123(a).

$6.16/MMBtu.[42] The 2010 AECO gas price Avista used to prepare its 2010 revenue requirement forecast was $7.48/MMBtu.[43]

Q: What were the results of that analysis?

A: The estimated value of the Contracts dropped dramatically, to near the value of the "Low Case" TL had originally estimated. These results are shown in Table 5 below.

Table 5. Impact of $1.00/MMBtu Gas Price Reduction on Estimated Value of Lancaster Contracts

AECO 2010 Gas Price ($/MMBtu)	Estimated Value ($/KWh)			
	Base	High	Low	
$7.16*	64	78	2	
$6.16**	8	n/a	n/a	

Sources:
*Exhibit No.__ (RLS-5), p. 21 of 31, Table 5.
**Avista Response to Public Counsel Data Request No. 238 and Woodruff workpapers

Q: How does the gas price you asked TL to simulate compare to recent and current gas prices?

A: The gas price I asked TL to simulate is still higher than recent gas prices. Over the three-month period of February through April, the average 2010 AECO gas price was $5.23/MMBtu – almost $2.00/MMBtu lower than the figure TL originally used to estimate the value of the Lancaster Contracts.[44] Further, Avista's Response to Public Counsel Data Request No. 496 stated that the 2010 AECO forward gas price, as averaged over the three months before August 5, was $5.36/MMBtu. And in early August, a snapshot of forward gas prices showed that they had not changed appreciably from recent months' levels.

[42] Exhibit No. ___ (RLS-5), p. 24 of 31.
[43] Exhibit No. ___ (CGK-1T), p. 7.
[44] Avista's Response to Public Counsel Data Request No. 213(a).

Q: What are the implications of such seemingly low gas prices for the value of the Lancaster Contracts?

A: If TL were to re-simulate the model using recent or current lower gas prices consistent with the direction of Public Counsel Data Request No. 238, the Contracts would have even lower value – possibly even a net negative value.

Q: If TL were to re-simulate its analysis with lower gas prices without the direction of Public Counsel Data Request No. 238, might they also make other reasonable changes that could produce further changes in results?

A: Yes. If TL were to prepare a forecast using a lower, long-term gas price forecast, I believe that TL would also review the future "resource plan" for the WECC, that is, the amount and mix of generating resources in the WECC. The result of such a review may be fewer CCCTs in their simulation, which would probably make remaining CCCTs – including the Lancaster Plant – more valuable than in the sensitivity they simulated pursuant to Public Counsel Data Request No. 238.

Q: What are the implications of the results of this gas price sensitivity on the value of the Lancaster Contracts?

A. The results of the gas price sensitivity have two key implications. First, it suggests that TL's Low Case may not be pessimistic enough, and that TL has not properly bounded the potential value of the Contracts. If so, the Commission does not have before it an estimate of the full range of possible outcomes for the value of the Contracts.

Second, this test suggests the Lancaster Contracts may not have positive value to Avista Utilities if current "low" gas prices persist through the future.

Q: What are the implications of your above criticisms of Avista's and TL's analyses?

A: Avista has failed to prove that the Lancaster Contracts will provide value to Avista Utilities' ratepayers.

Q: Are you taking any positions on other aspects of Avista's or TL's analyses?

A: Except as described in the following section, not at this time. My silence on these matters should not be taken as either agreement or disagreement with any other aspect of either Avista's or TL's analyses.

Q. How could Avista cure the problems with its analyses of the value of the Lancaster Contracts?

A. Ideally, Avista would conduct the RFP process the Commission's policies require.

F. Lancaster Contracts Are Severable

Q: Do you have any other concerns about Avista's proposal to assign the Lancaster Contracts and the analyses Avista and TL have conducted of the Contracts' value?

A: Yes. Avista is proposing to assign *all* the Lancaster Contracts described above to Avista Utilities in their entirety. Avista's and TL's analyses are also based on this assumption (though they also assume Avista will recover some such transmission and gas transportation costs through re-marketing).

Yet, as Avista has acknowledged, there is nothing within any of the Contracts that require them to be held, assigned or administered together.[45] That is, each of the

[45] Avista's Response to Public Counsel Data Request No. 229.

Contracts is severable from each of the others, and Avista has the option to assign *or not assign* each separate contract to Avista Utilities.

Q: What is the significance of the Lancaster Contracts' severability to assessing Avista's proposal to assign the Contracts to Avista Utilities?

A: The Contracts' severability means that the value of each contract to Avista Utilities can be assessed separately or in various combinations. In the interest of its ratepayers, Avista Utilities thus should have assessed which of the Contracts – individually or in various combinations – would provide ratepayers the greatest net value. The lack of such an analysis leaves the Commission without full information as to the best combination of such contracts, if any, to allow to be assigned to Avista Utilities.

Q: Is Avista correct to state "[f]rom a practical standpoint, however, the gas transportation and transmission contracts need to be assigned to Avista Utilities in order to generate and receive the power from the Lancaster PPA"?[46]

A: No. It may have made sense for Avista's unregulated entities to enter the three sets of contracts in the 1990s, but that does not mean it makes sense for all the Contracts to be assigned to Avista Utilities starting next year. For example, the BPA transmission contract may prove to be entirely unnecessary for delivering power from the Plant to Avista Utilities' system. As such, assignment of that contract would impose an extra, unnecessary cost on Avista Utilities' ratepayers. In addition, the GTN and TransCanada gas transportation contracts are larger than necessary to provide firm gas transportation service to the Plant. Assignment of all of the

[46] *Id.*

Lancaster Contracts to Avista Utilities would thus impose unnecessary costs on Avista Utilities' ratepayers.

Q: Why do you say the BPA transmission contract may be unnecessary?

A. Avista has stated that it is exploring, and expects to develop, a new transmission interconnection between the Plant and its own system.[47] Such an interconnection would enable the Plant to deliver power directly into Avista Utilities' system, largely or entirely bypassing BPA's transmission system, thus rendering the BPA transmission contract largely or entirely unnecessary for that purpose.

Q: What does Avista state it will do with any such excess BPA transmission capacity?

A: Avista forecasts that it will effectively recover about 75 percent of the costs of the BPA transmission contract by reselling or "otherwise optimizing" such capacity.[48]

However, this cost recovery assumption is a mere forecast. As noted in Table 1 above, under Avista's proposal in this docket, Avista Utilities' ratepayers would be required to pay the entire fixed costs of the BPA transmission contract – which are estimated to start at approximately $4.7 million in 2010 and escalate through 2026 – regardless of whether the capacity is used and/or how such capacity is used. It is likely Avista Utilities will recover some of these costs through managing this asset. But Avista has failed to show that Avista Utilities' customers should assume this risk in the first place.

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[47] Exhibit No. ___ (RLS-4), p. 3. Avista's Response to Public Counsel Data Request No. 304 states Avista is studying such an interconnection with BPA and expects to provide more information this month.
[48] Exhibit No. ___ (RLS-4), p. 3 and Avista's Response to Public Counsel Data Request No. 107.

Q: Would the proposed direct connection between the Plant and Avista's system be less costly to ratepayers than the BPA transmission contract?

A. Yes, it is likely. Avista has forecast the interconnection would cost about $3 million per year in capital costs.[49] This would yield an annual revenue requirement of only about $500,000per year, barely one-tenth of the cost of the BPA contract.

Q: Is it certain that the proposed direct connection will be made?

A: No. Avista said it is still studying the proposed interconnection with BPA and will provide more information this month.[50]

Q: Are the Lancaster Contracts beneficial to ratepayers if the proposed interconnection is not built?

A. According to Avista's own testimony, the failure to build a direct connection between the Plant and its system would substantially reduce the value of the Lancaster Contracts. Given the "materiality" of the BPA transmission contract costs, in its DCF study, TL tested the impact of different assumptions regarding the recovery of BPA transmission costs on their estimate of the Contracts' value.[51] That assessment is provided in Table 6 below.

At the Avista-specified assumption that 75 percent of such costs are recovered, TL estimated the Contracts offer a value of $64 per kilowatt-year (kW-yr). However, if none of the costs are recovered – as might happen if no direct connection is built – *the Contracts' value falls to less than zero.* And the value is

[49] Exhibit No. ___ (RLS-4), p. 3.
[50] Avista's Response to Public Counsel Data Request No. 304.
[51] Exhibit No. ___ (RLS-5), pp. 18-19.

virtually zero – at $2/kW-yr – using Avista's assumption that "up to 25%" of such costs might be recoverable if the direct connection is not built.[52]

Assumptions regarding the BPA transmission contract thus hang heavily over any analysis of the value of the Lancaster Contracts. I discuss means for addressing this concern in the next section.

Table 6. Impact of Transmission Cost Recovery on Value of Lancaster Contracts		
% of Costs Remarketed	**Value ($000s)**	**Value ($/kW)**
0%	($7,500)	($29.00)
25%*	500	$2.00
33%	3,000	$12.00
50%	8,500	$33.00
67%	13,750	$52.00
75%**	16,500	$64.00
100%	24,750	$94.00
Source: Exhibit No.__ (RLS-5), p. 19, Table 6.		
*Avista assumption on transmission re-marketing "without" direct connection, per Response to Public Counsel Data Request No. 107(b).		
** Thorndike Landing "Base Case," with direct connection, per above Source.		

Q: Why do you say the GTN and TransCanada gas transportation contracts are oversized?

A. The GTN contract provides delivery capacity to the Plant that exceeds the Plant's maximum gas demand by about 20 percent, as TL acknowledge in its analysis.[53]

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[52] Avista's Response to Public Counsel Data Request No. 107(b).
[53] Exhibit No. ___ (RLS-5), p. 8.

Q: Is such excess gas transportation capacity of value to Avista Utilities' ratepayers?

A: There may be some benefits to ratepayers of holding such surplus gas pipeline capacity. But it is unlikely that such benefits will exceed the costs of such extra capacity, and there is no reason to impose the risk of recovering the costs of surplus capacity on Avista Utilities' ratepayers.

Q. How should Avista have addressed the severability of the Lancaster Contracts in its analyses?

A. As discussed above, ideally Avista would conduct the RFP process the Commission's policies require. As part of that process, Avista would consider the value of each of the Lancaster Contracts against other alternatives for getting the same services. Such analyses would explicitly treat the Contracts as severable.

G. Recommendations for Commission Action on Lancaster Contracts

Q: What actions do you believe the Commission should take regarding Avista's proposal to assign the Lancaster Contracts to Avista Utilities?

A: I believe the Commission should take actions addressing three discrete issues.

First, the Commission should find that – in deciding to assign the Lancaster Contracts to Avista Utilities – Avista did *not* comply with the various prudence and other criteria cited above governing resource procurement.

Second, the Commission should reject assignment of any of the Lancaster Contracts to Avista Utilities for calendar year 2010.

Third, the Commission should choose between two actions with regard to the assignment of the Lancaster Contracts from 2011 forward. First, the Commission has strong bases to reject Avista's proposed assignment of the Lancaster Contracts to Avista Utilities for all years from 2011 to 2026, and could reasonably choose to do so.

However, the Commission could also reasonably choose to allow the assignment of the Lancaster PPA and eighty percent of the gas transportation contracts to Avista Utilities – but reject the assignment of the BPA transmission contract and the remaining twenty percent of the gas transportation contracts to Avista Utilities. These latter contracts should remain the responsibility of Avista's unregulated subsidiaries.

Q: Why do you make the first two recommendations?

A: I explain the basis for the first two recommendations in my testimony above.

Q: Why do you offer the Commission two courses of action in your third recommendation?

A: I offer two alternative courses of action in my third recommendation to provide the Commission two reasonable alternatives to Avista's proposal to assign all of the Lancaster Contracts to Avista Utilities.

First, as shown above, the Commission has good reason to reject the assignment of the Lancaster Contracts outright.

But if the Commission feels the Contracts have some chance of providing net benefits to Avista Utilities' ratepayers, it could also reasonably require Avista Utilities to demonstrate the value of the Lancaster Contracts, individually and together, by issuing an RFP to obtain other offers for firm, long-term CCCT capacity delivered to Avista's service territory. However, managing an entire RFP process and bringing the results to this Commission for approval could take many months. I am thus reluctant – for reasons of practicality – to argue that Avista should be required to take such steps.

Instead, if the Commission concludes there are benefits to ratepayers, I believe the Commission could act much more quickly and surely to secure the perceived benefits by approving Avista's proposed assignments of the Lancaster Contracts with the modifications discussed above. While this would be a divergence from Commission procurement policy in this instance, it would be warranted if the Commission decides that the Lancaster Contracts' terms can be reasonably expected to be favorable for Avista Utilities' ratepayers over the long-term – given the adjustments I proposed above.

IV. 2010 REVENUE REQUIREMENTS SHOULD BE BASED ON UPDATED GAS PRICES

A. 2010 Revenue Requirements Should Be Based On Updated Gas Prices

Q: What are the dates of the gas prices Avista used to forecast its 2010 power supply costs?

A: Avista forecast its 2010 power supply costs based on gas prices averaged over the period of September 1, 2008 to November 30, 2008.[54] Avista has stated that this methodology is consistent with the Commission's direction on such gas price forecasts.[55]

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[54] Exhibit No. ___ (CGK-1T), p. 6, ll. 18-19.
[55] Avista's Response to Public Counsel Data Request No. 169.

Q: Should the Commission adopt revenue requirements based on a gas price forecast of that vintage?

A: No. Revenue requirements should be based on gas prices that are still reasonably current. The gas prices Avista used were reasonably current when Avista prepared its forecast, but – as of the date of this testimony – gas prices have fallen substantially since then. An update should be made to help set 2010 revenue requirements.

Q: What general criteria do you suggest the Commission apply to adopting updated gas prices for purposes of estimating revenue requirements?

A. The Commission should balance two conflicting criteria. A revenue requirements forecast for a year should be based on gas prices that are gathered as close as possible to the start of the year. But, such updates must be made in a manner that allows Avista to prepare its forecast in a deliberate manner and allows the Commission and the parties adequate time to review Avista's forecast with some care, subject to any legal limits on increasing revenue beyond proposed tariffs filed with the Commission.

Q: Do you have a specific recommendation for the filing date in this case of a power supply cost forecast based on updated gas prices?

A: Yes. At this time, the best gas price to use to update revenue requirements appears to be the forecast Avista prepared in response to Public Counsel's Data Request No. 496, which is attached to my testimony as Exhibit No. ___ (KDW-8). This update results in a reduction in Avista's power costs ~~to be recovered~~ of $30,384,694,

~~in this case of $ 30,384,694~~ which is a reduction of $19,625,474 on a Washington jurisdictional basis.[56]

V. RECOMMENDATIONS AND CONCLUSION

Q. Please summarize the impact of your recommendations on Avista's power cost to be recovered in this rate case.

A In order to reflect the decline in natural gas costs, based on the Avista's Response to Public Counsel Data Request No. 496, Avista's system power costs should be reduced by $30,384,694, which is a reduction of $19,625,474 on a Washington jurisdictional basis.

In addition, my recommendation with respect to the Lancaster Contracts has the effect of reducing the Avista system power costs ~~request~~ by an additional $18,292,982 (as shown in Table 2), which is a reduction of $11,815,437 on a Washington jurisdictional basis. As a result my total recommended reduction in Avista system power costs is $48,677,676, which is a reduction of $31,440,911 on a

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[56] This and the following allocations of adjustments of Avista system costs to Washington ratepayers are computed by multiplying such system cost adjustments by the Washington allocation factor of 64.59 percent. This allocation factor was documented in the Electric Workpapers of Elizabeth M. Andrews, page PFI$_2$.

1 Washington jurisdictional basis. These adjustments are shown below, in Table 7.

Table 7. Public Counsel Adjustments for Lower Gas Prices and Lancaster Contracts		
Power Supply Fuel & Market Expense:	System Basis	**Washington Jurisdictional**
Original Filing	$116,245,068	**$75,082,689**
8/5/09 Updated	$85,860,374	**$55,457,216**
Updated Cost Adjustment:	($30,384,694)	**($19,625,474)**
Lancaster Contracts:		
Value of Lancaster Contracts	$16,999,018	**$10,979,666**
Costs of Lancaster Contracts	($35,292,000)	**($22,795,103)**
Lancaster Contracts Adjustment:	($18,292,982)	**($11,815,437)**
Total Public Counsel Adjustment for Lower Gas Prices & Lancaster Contracts	($48,677,676)	**($31,440,911)**
Sources: Avista's Response to Public Counsel Data Request No. 496, and Electric Workpapers of Elizabeth M. Andrews, page PFI2.		

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3 **Q: Does this conclude your testimony?**

4 A: Yes.