

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-090134

DOCKET NO. UG-090135

DOCKET NO. UG-060518

(consolidated)

REBUTTAL TESTIMONY OF

KELLY O. NORWOOD

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

Q. Please state your name, employer and business address.

A. My name is Kelly O. Norwood. I am employed by Avista Utilities as the Vice-President of State and Federal Regulation. My business address is 1411 E. Mission Avenue, Spokane, Washington. I am a graduate of Eastern Washington University with a Bachelor of Arts Degree in Business Administration, majoring in Accounting. I joined the Company in June of 1981. Over the past 28 years, I have spent approximately 17 years in the Rates Department with involvement in cost of service, rate design, revenue requirements and other aspects of ratemaking. I spent approximately 11 years in the Energy Resources Department (power supply and natural gas supply) in a variety of roles, with involvement in resource planning, system operations, resource analysis, negotiation of power contracts, and risk management. I was appointed Vice-President of State & Federal Regulation in March 2002.

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

A. The first part of my rebuttal testimony will address the Washington Utilities and Transportation Commission Staff's (Staff) rejection of a number of pro forma adjustments proposed by the Company, claiming that they are not proper pro forma adjustments. I will demonstrate how the Staff has not properly applied the three principles or concepts related to proper pro forma adjustments.

Next, I will address why it makes sense to reduce the ERM surcharge coincident with the effective date of new rates in this proceeding. I am presenting a revised proposal in that regard.

Finally, I will provide the Company's reply to the direct testimony of Staff, the Public Counsel Section of the Washington State Attorney General's Office (Public Counsel), The Energy Project, and the Northwest Energy Coalition (NVEC), together referred to as the "parties", as it

1 relates to the Company's Decoupling Mechanism. Further, I will introduce certain issues that will
2 be addressed by Mr. Hirschhorn and Mr. Powell, witnesses for the Company.

3 **II. OTHER COMPANY WITNESSES**

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

6 A. Yes. The following additional witnesses are presenting rebuttal testimony on
7 behalf of Avista:

8 Ms. Elizabeth Andrews, Manager of Revenue Requirements, will first explain the
9 Company's revised revenue requirements for both electric and natural gas after taking into
10 consideration the agreed-upon components of the Partial Settlement¹, and to reflect any
11 corrections and adjustments to actual costs that have been identified through the discovery
12 process. After these adjustments, the Company's revised increase in revenue requirement for its
13 Washington electric and natural gas services is **\$37,475,000** and **\$2,849,000**, respectively. The
14 revised rate base for the Company's electric service is \$1,012,855,000, while the natural gas rate
15 base remains unchanged from that filed in its direct case at \$178,263,000. She also responds to a
16 number of proposed adjustments by Staff and other parties.

17 Mr. Dave DeFelice, Senior Business Analyst, will review the Company's proposed
18 regulatory treatment of capital investments in utility plant and why the Company's proposal is the
19 proper method to "match" revenues, expenses and rate base for ratemaking purposes. He will
20 also address the adjustments related to capital expenditures proposed by Commission Staff
21 witness Mr. Kermode and by Public Counsel witness Mr. Larkin, Jr., and why their methods do

¹ On September 4, 2009 the Company filed a Partial Settlement Stipulation with all parties to Docket Nos. UE-090134, UG-090135 and UG-060518 (consolidated) agreeing to capital structure, power supply adjustments (except Lancaster) and removal of the Company's pro forma generation O&M adjustment filed in its direct case.

1 not fairly state costs and rate base. He concludes by providing an alternate approach for the
2 Commission to consider, should the Commission choose to use a method other than that
3 proposed by Avista.

4 Mr. James M. Kensok, Vice President and Chief Information Officer, responds to Staff
5 and intervenor testimony regarding the Information Services expense for 2009 that is being
6 requested above the test period amount, attesting that such costs are known & measurable, with
7 only a few instances of offsetting revenues or cost-savings.

8 Mr. Richard Storro, Vice President of Energy Resources, responds to Staff and intervenor
9 testimony regarding generation-related capital projects that will be completed and in-service by
10 the end of 2009 that are included in this case, as known & measurable.

11 Mr. Scott Kinney, Director, Transmission Operations, responds to Staff and intervenor
12 testimony regarding transmission and asset management electric distribution related capital
13 projects that will be completed and in-service by the end of 2009 and that are included in this case
14 as known & measurable. He will also provide responsive testimony on the Company's Asset
15 Management Program, and why these costs should be recovered at this time.

16 Ms. Heather L. Cummins, Director, Business Process Improvement, in response to Staff
17 and Public Counsel testimony on pro forma rate base, describes six electric distribution projects
18 noted by Mr. DeFelice, explains how customers will benefit from these projects, and describes
19 the Company's approach to determine any off-sets that were used.

20 Mr. David R. Howell, Gas Engineering Design Manager, in response to Staff and Public
21 Counsel testimony on pro forma rate base, provides testimony related to capital investment in
22 natural gas distribution projects in 2009 as previously presented by Mr. DeFelice.

1 Ms. Tara Knox, Senior Regulatory Analyst, addresses the Company’s position regarding
2 the proper calculation of the production property adjustment, and the objections raised by
3 Commission Staff and Public Counsel.

4 Mr. Clint Kalich, Manager of Resource Planning & Power Supply Analyses, discusses
5 why the Lancaster Power Purchase Agreement is prudent and should be approved.

6 Mr. Robert J. Lafferty, Director, Power Supply, addresses why the Bonneville Power
7 Administration (BPA) transmission contracts and the natural gas transportation contracts
8 associated with the Lancaster Power Purchase Agreement are prudent and necessary for the
9 operation and optimization of Avista’s power resources.

10 Mr. Brian Hirschhorn, Manager of Pricing, describes the New Customer Adjustment and
11 why it is imperative that it be retained as part of the monthly deferral calculation if the
12 Decoupling Mechanism is continued. He also addresses the recommendations for changes in the
13 natural gas basic charge.

14 Mr. Jon Powell, Manager, Demand Side Management, shows that, although there are a
15 few elements related to the Company’s DSM program administration that were identified as
16 problematic, the overall Decoupling Mechanism is still sound.

17 **III. PROPER PRO FORMA ADJUSTMENTS**

18 **Q. In Staff’s testimony they recommend rejection of a number of pro forma**
19 **adjustments proposed by the Company, claiming that they are not proper pro forma**
20 **adjustments. What are the issues raised by Staff related to their recommendation?**

21 A. Staff addresses essentially three issues in their testimony related to proper pro
22 forma adjustments. Their testimony is that in order for pro forma adjustments to be proper, they

1 must be consistent with the following principles or concepts. For ease of reference, I will refer to
2 these in my testimony as “principles.”

- 3 1. The pro forma adjustments should be “known and measurable,”
- 4
- 5 2. The adjustments should take into account any “offsetting factors,” and
- 6
- 7 3. The adjustments should preserve the relationship of changes in revenues, expenses
- 8 and rate base during the ratemaking period, which we refer to as the “matching
- 9 principle.”
- 10

11 **Q. Do you agree that pro forma adjustments for ratemaking purposes should be**
12 **consistent with these three principles?**

13 A. Yes. I believe, however, that Staff has not properly applied these principles.

14 **Q. Would you please summarize your concerns related to Staff’s application of**
15 **these principles?**

16 A. Yes.

17 Known and Measurable

18 In its testimony, Staff suggests that in order for pro forma adjustments to pass the “known
19 and measurable” test the dollars associated with the adjustments must be known with certainty,
20 and/or based on historical test year values. In my testimony I will show that it has been common
21 practice for pro forma adjustments to be approved by the Commission based on reasonable
22 estimates for the rate year. In fact, in this case Staff has recommended approval of Avista’s pro
23 forma adjustment related to the Noxon Unit No. 3 hydroelectric project upgrade based on the
24 following rationale expressed by Staff witness Mr. Kermode:

25 “[T]he Commission has allowed inclusion in rate base of plant that will be used and useful
26 during the rate year. There must be a reasonable expectation that the plant will be complete
27 and the costs are prudent.” (emphasis added) (Kermode Revised Exhibit (DPK-1T) , at
28 page 40).

1

2 In fact, “if reasonable estimates” were not allowed in ratemaking for the prospective rate
3 year, it would be impossible for the Company to have the opportunity to recover its costs of
4 providing service to customers during the period that retail rates will be in effect, and it would not
5 have the opportunity to earn a fair rate of return.

6 Offsetting Factors

7 In his testimony on page 8, beginning on line 12, Staff witness Mr. Parvinen states as
8 follows:

9 However, because any investment a utility makes should be supported by a rational and
10 prudent management decision, there is inherently a return on such investment immediately
11 upon its being placed into service, whether it is an efficiency improvement leading to
12 reduced maintenance, fewer outages (reliability), or growth in customers (revenues). If
13 there is no such benefit, the Commission should question why the decision to invest was
14 made. (emphasis added)
15

16 Mr. Parvinen, however, provides no support for his general assertion that “there is
17 inherently a return on such investment immediately upon its being placed into service.” This
18 statement is simply not true. For example, every year Avista is required to move some of its
19 facilities to accommodate changes to transportation corridors (road moves) by state and local
20 government entities. There are no additional revenues or reduction in expenses associated with
21 these required investments. This is just one example. Mr. Kinney and Mr. DeFelice in their
22 testimony provide significant detail on the proposed rate base additions, and explain why there are
23 no offsets for the specific pro forma rate base additions proposed by the Company in this case,
24 except where otherwise noted. Avista has specifically excluded rate base additions that have
25 offsetting revenues and/or expenses.

26 Matching

1 In its testimony related to the “matching principle”, Commission Staff uses terminology
2 including “average-of-monthly-average” (AMA), “end-of-period,” and the “production property
3 adjustment.” In my rebuttal testimony, I will demonstrate how Avista’s use of the 2009 “end-of-
4 period” rate base actually results in lower costs to customers in this case than the 2010 “AMA” rate
5 base that should properly be included in rates. I will address how the “production property
6 adjustment” appropriately reduces the pro forma rate base back to the historical test year to set
7 retail rates. And finally, I will demonstrate, with regard to the “matching principle,” that Avista’s
8 rate base proposal in this case actually understates costs to customers, and therefore, any mismatch
9 that would occur is in the customers’ favor, i.e., revenues from customers would be less than the
10 costs associated with the utility investment used to serve customers.

11 **Q. Is Staff’s opposition to the 2008 and 2009 rate base additions based on a claim**
12 **that the investments were imprudent?**

13 A. No. Staff has not taken issue with the prudence of any of the expenditures. Their
14 opposition is based on concerns related to the three principles identified above.

15
16 **A. KNOWN AND MEASURABLE**

17 **Q. Please explain your disagreement with Staff and other parties regarding their**
18 **application of the “known and measurable” principle.**

19 A. On page 5, beginning on line 9, of his testimony Mr. Parvinen provides an example
20 to illustrate the “known and measurable” principle as follows:

21 A classic example is an increase in postage rates that the United States Postal Service has
22 ordered to go into effect by a date certain. This will affect the Company’s cost of mailing
23 utility bills to its customers. This price change is known because it is certain to occur and
24 the change in price is known. The price change is measurable because the new price can be
25 applied to the test year units of postage, to calculate the pro forma level of postage expense.

1 The adjustment for the change in postage rates is therefore “known and measurable.”
2 (emphasis added)

3

4 I have underscored the words “certain” and “test year units,” because Mr. Parvinen seems
5 to imply that known and measurable involves certainty and test year (historical year) values.

6 **Q. Is that consistent with prior ratemaking treatment in Washington regarding**
7 **the known and measurable principle?**

8 A. No. With regard to “known and measurable”, there are numerous pro forma
9 adjustments that are routinely included in general rate cases that have been consistently supported
10 by the Commission Staff, and other parties, and have been approved by the Commission that do
11 not involve certainty of the prices or volumes, and do not involve historical test year values. These
12 pro forma adjustments are included, in part, because we know for certain that the historical test
13 year values are not correct, and do not represent the level of revenues, expenses and rate base that
14 the Company will experience during the rate year in serving its customers.

15 For example, the power supply costs for ratemaking purposes include pro forma
16 adjustments (in recent cases and this case) based on a three-month average of future natural gas
17 prices for the future rate year for thermal generation. These wholesale market gas prices are not
18 known with certainty to occur for the rate year, but are based on the best available information and
19 provide the best representation of the costs the Company expects to occur during the rate period.
20 In addition, the volume of natural gas to be purchased for generation in the rate year is based on
21 modeled estimates of thermal generation using estimated loads, estimated hydroelectric conditions,
22 estimated availability factors for the thermal plants, and other estimates of wholesale market
23 conditions.

1 In addition, pro forma costs for small power (e.g., PURPA) generation projects are based
2 on an estimated level of generation (five-year average) for ratemaking purposes. These are just a
3 few examples of pro forma adjustments that are regularly accepted by the parties to rate cases, as
4 well as the Commission, which are not based on numbers with certainty or values from the
5 historical test year, but are based on reasonable estimates for the rate year.

6 Ratemaking is not an exact science; reasonable assumptions need to be made to assure that
7 the Company will have a reasonable opportunity to recover its prudently incurred costs.

8 **Q. Are there examples of pro forma adjustments that are not related to power**
9 **supply?**

10 A. Yes. The pro forma expense for “injuries and damages” is based on a six-year
11 rolling average of actual payments for injuries and damages not covered by insurance, instead of
12 the test year amount.

13 A five-year average for OASIS wheeling revenues is used in every rate case, because these
14 revenues vary year to year depending on wholesale electric market conditions. Avista has, in the
15 current and previous rate cases, used the most recent five-year average as being representative of
16 future expectations unless there are known events or factors that occurred during the period that
17 would cause the average to not be representative of future expectations.

18 A second transmission revenue example includes the adjustment for Dry Gulch revenue.
19 The methodology used to normalize Dry Gulch revenue is a five-year average of actual revenue. A
20 five-year average is used since the revenue can vary from year to year. The revenue is calculated
21 using a 12-month rolling ratchet based on monthly peak demands. Load peaks are very sensitive to
22 temperatures, which vary from year to year.

1 Again, these are just a few examples of pro forma adjustments that are not based on
2 historical test year values or known with certainty, but which are consistently adopted by the
3 parties and the Commission case after case, as being reasonable estimates of revenues and
4 expenses during the rate year.

5 **Q. Do you have examples of pro forma adjustments for rate base?**

6 A. Yes. The Noxon Rapids hydroelectric plant Unit 3 upgrade is one example in this
7 case. This upgrade is expected to be completed in April 2010, has been pro formed into this case
8 by the Company, and is not opposed any party to the case. The pro forma adjustment is based on
9 an estimated investment cost, and an estimated in-service date.

10 On page 39, line 23 of Mr. Kermode’s testimony he included the following question and
11 answer related to the Noxon rate base addition:

12 Q. Can budgeted post test-year plant additions be included in rate base?

13 A. It is rare that plant that is not complete and used and useful will be included in rate
14 base. However, the Commission has allowed inclusion in rate base of plant that will
15 be used and useful during the rate year. There must be a reasonable expectation that
16 the plant will be complete and the costs are prudent. It is Staff’s opinion that the plant
17 will be completed as scheduled and that the Noxon #3 upgrade was prudent.
18 (emphasis added)
19

20 Here Mr. Kermode notes that the Commission allows post test-year rate base additions that
21 will be in service during the rate year, and makes the important point that the plant addition will be
22 “used and useful” because it will be providing service to customers “during the rate year.” With
23 regard to known and measurable, here Mr. Kermode makes reference to a “reasonable expectation”
24 that the plant will be complete.

25 I do not agree with Staff’s reference to these adjustments being “rare.” The Commission
26 has approved many of these types of pro forma adjustments in the past. Staff’s own testimony

1 identifies other such adjustments including pro forma adjustments in recent cases related to
2 Avista's transmission upgrades, and adjustments related to other generating projects, such as when
3 Colstrip was placed into service, or the more recent upgrades to Colstrip – all of which involved
4 estimated costs and estimated in-service dates.

5 **Q. Is there language from prior Commission orders that provide guidance**
6 **regarding pro forma adjustments and the known and measurable principle?**

7 A. Yes. In the WUTC's 6th Supplemental Order in Docket No UW-010877, dated July
8 12, 2002, the Commission enunciated the following principle with regard to adjustments to the
9 historical test year, noting that adjustments will be made:

10 ...for known and measurable events that will occur prospectively (pro forma adjustments),
11 to best estimate the relationship between the Company's costs and revenues and thus
12 establish rates that are fair, just, and reasonable and allow the Company the opportunity to
13 earn a fair rate of return. (emphasis added)
14

15 Here the Commission has clearly recognized the need to use reasonable estimates for the
16 rate year in the ratemaking process. In fact, if reasonable estimates were not allowed in ratemaking
17 for the rate year, it would be impossible for the Company to have the opportunity to recover its
18 costs of providing service to customers during the period that new rates will be in effect, and it
19 would not have the opportunity to earn a fair rate of return.

20 **Q. Does the Company have a robust planning and management process to develop**
21 **and track planned capital additions to utility plant?**

22 A. Yes. The 2009 and 2010 planned capital additions are developed by the various
23 departments within the Company during the 2009 capital budgeting process and approved by
24 management. During the capital budget process, engineers determine what projects need to be
25 built to keep Avista's systems working and viable. On an annual basis, departments submit their

1 capital budget proposals for officer approval. After a project is approved, all of the projects are
 2 tracked by the Analysis, Budget and Forecast Group by entering the projects into the budget
 3 system. Several individual projects may roll up to a master capital project referred to as an
 4 Expenditure Request, which groups like-projects and makes the budget system manageable. Costs
 5 must be provided on a monthly basis so that an accurate AFUDC calculation can be made, if
 6 applicable, and to aid in cash forecasting.

7 **Q. How have the actual capital expenditures for the utility compared with the**
 8 **planned expenditures in recent years?**

9 A. The actual and planned capital expenditures for the utility for the years 2005
 10 through 2008 are shown in the table below. The table shows that actual capital expenditures have
 11 been very close to the planned expenditures on a consistent basis. During the last two years the
 12 actual expenditures have been 98% of the planned expenditures. I believe it is fair to conclude that
 13 there is a high level of confidence that the planned capital expenditures for at least 2009, which the
 14 Company has pro formed into this case, will occur and it is reasonable for them to be included for
 15 recovery in retail rates.

	Planned Expenditures (\$millions)	Actual Expenditures (\$millions)	Percentage of Planned (%)	
20	2005	\$132.3	\$126.8	96%
21	2006	\$159.6	\$152.8	96%
22	2007	\$183.6	\$179.4	98%
23	2008	\$194.2	\$190.2	98%

24

1 **Q. Please summarize your testimony related to the relationship of pro forma**
2 **adjustments and the “known and measurable” principle.**

3 A. There are many examples where Staff and other parties have supported pro forma
4 adjustments for the rate year where the dollar amounts are not known with certainty, but are based
5 on reasonable estimates. In fact, it goes well beyond just examples -- to it being common practice
6 for the Commission to approve such pro forma adjustments for the rate year.

7 The pro forma adjustments proposed by the Company should not be rejected because some
8 of the numbers are not known with certainty. Estimates have been used on a regular basis in prior
9 cases because they provide a reasonable representation of the expenses, revenues and rate base for
10 ratemaking purposes, and because without such pro forma adjustments retail rates would not be
11 fair, just, reasonable, and sufficient, and the Company would not have the opportunity to earn a fair
12 rate of return.

13 **B. OFFSETTING FACTORS**

14 **Q. Please explain your disagreement with Staff and other parties regarding their**
15 **application of the “offsetting factors” principle.**

16 A. In his testimony on page 8, line 1, Mr. Parvinen makes the following statement:
17 Virtually all rate base additions have an impact on service, costs, and/or revenue whether
18 the addition is a replacement, for growth, or simply a required addition. (emphasis added)
19
20 If, by this statement, Mr. Parvinen is suggesting that “virtually all rate base additions” have
21 revenue or expense offsets, he provides no support for this proposition, and it is simply not true.
22 For example, as explained earlier, every year Avista is required to move some of its facilities to
23 accommodate changes to transportation corridors (road moves) by state and local government

1 entities. There are no additional revenues or reduction in expenses associated with these required
2 investments.

3 In addition, as Mr. Kinney points out in his testimony, the North American Electric
4 Reliability Corporation (NERC) requires sufficient redundancy in Avista's transmission and
5 substation equipment such that a simultaneous outage on two different facilities would not prevent
6 the Company from continuing to serve customers' loads, and would not cause a disruption on a
7 neighboring utility's system. This requirement has required Avista to spend addition capital
8 investment to create and sustain this redundancy. This redundancy does not provide offsetting
9 revenues or a reduction of expenses. It is an additional cost of meeting a federal requirement.
10 These are just a couple of examples. Mr. Kinney and Mr. DeFelice in their rebuttal testimony
11 provide significant detail on the specific additions themselves, and why there are no offsets for the
12 pro forma rate base additions proposed by the Company, except where otherwise noted.

13 **Q. On page 8, line 12 Mr. Parvinen makes the following statement:**

14 **“However, because any investment a utility makes should be supported by a rational**
15 **and prudent management decision, there is inherently a return on such investment**
16 **immediately upon its being placed into service, whether it is an efficiency**
17 **improvement leading to reduced maintenance, fewer outages (reliability), or growth**
18 **in customers (revenues). If there is no such benefit, the Commission should question**
19 **why the decision to invest was made.”**

20

21

22 **Do you have any comments on this testimony?**

23 A. Yes. I agree with Mr. Parvinen that “any investment a utility makes should be
24 supported by a rational and prudent management decision,” and as I noted earlier in my testimony,
25 neither Staff, nor any other party, has not taken issue with the prudence of any of the rate base
26 additions proposed by the Company. I disagree, however, with the conclusions that he draws in the
27 remainder of this portion of his testimony.

1 Mr. Parvinen provides no support for his statement that “there is inherently a return on such
 2 investment immediately upon its being placed into service.” Again, this statement is simply not
 3 true. In the example of the road moves I provided above, there would be absolutely no return on
 4 the investment after it is placed into service, and the Company would not recover its costs and earn
 5 a return until it is included in rate base. If there is no additional revenue or reduced expense
 6 following the time it goes into service, then there is no return of the investment or on the
 7 investment.

8 Finally, Mr. Parvinen states that, “If there is no such benefit, the Commission should
 9 question why the decision to invest was made.” This statement completely ignores the
 10 responsibility of the utility to make investments to, among other things, comply with federally-
 11 mandated reliability requirements, and to replace aging facilities. These types of investments do
 12 not provide offsetting benefits of increased revenues or reduced expenses, but they are clearly the
 13 responsibility of the utility.

14 On Pages 10 and 11 of Mr. Parvinen’s testimony he identifies the following excerpts from
 15 Avista testimony that he claims supports the existence of offsetting revenues or expenses related to
 16 rate base additions:

- 17 a. “...enhance transmission system reliability and efficiency, provide cost-effective region
 18 transmission planning,...” Exhibit No. ____ (SJK-1T), page 3, lines 4-6
- 19 b. “...enhance reliability in Columbia Grid Footprint. ...expanding the existing regional
 20 coordinating outage management process, ... improved system modeling,...” Exhibit No.
 21 ____ (SJK-1T), page 4, lines 8-11
- 22 c. “...meet capacity needs, eliminate thermal loading issues, replace deteriorating
 23 equipment,...” Exhibit No. ____ (SJK-1T), page 12, lines 17-18
- 24 d. “...increase the capacity of the substation bus,...improves reliability and operating
 25 flexibility.” Exhibit No. ____ (SJK-1T), page 13, lines 8-10
- 26 e. “...provide improved service to customers.” Exhibit No. ____ (SJK-1T), page 14, line 5

- 1 f. "...mitigate thermal overloads experienced..." Exhibit No. ____ (SJK-1T), page 14, lines
2 17-18
- 3 g. "All these individual projects improve system reliability and customer service." Exhibit
4 No. ____ (SJK-1T), page 15, line 30
- 5 h. "...meet capacity needs of the system, improve reliability,..." Exhibit No. ____ (SJK-1T),
6 page 16, lines 11-12

7

8 However, Mr. Parvinen failed to identify for any of the items, the nature of the reduction in
9 expenses and/or increase in revenues (offsets) that Staff expects to occur. Nor did he provide an
10 estimate of the offsets, or even an order of magnitude for the supposed offsets. He simply makes
11 an assumption, without any support.

12 **Q. But with respect to Avista's proposed pro forma capital additions, wouldn't**
13 **there be some operation and maintenance (O&M) savings associated with the replacement of**
14 **some of the aging equipment with new equipment?**

15 A. Not when you look at the total utility as a whole, which is how ratemaking is done.
16 At some point our facilities approach the end of their useful lives and need to be replaced before
17 they fail. Our general practice is to attempt to replace our aging equipment before it fails, because
18 it is not only less costly to replace this equipment on a structured, planned basis, but it also results
19 in more reliable service to customers, which is expected by all utility stakeholders. If our practice
20 were to avoid replacing utility equipment until it failed, the reliability of our system would suffer.

21 Therefore, it is imperative that we continue every year to reinvest and upgrade a portion of
22 our utility system, in addition to the investments to meet mandatory reliability requirements, so that
23 our system will continue to provide reliable service. On a net basis, we will continue to experience
24 O&M costs to maintain a system that continues to age. Our O&M costs are continuing to go up
25 over time, not down. The reinvestment and upgrades actually serve, to a large extent, to allow the

1 Company to avoid additional costs in the future associated with maintenance – not to reduce the
2 overall level of existing O&M costs. Mr. Kinney provides additional testimony in this area.

3 On page 9, line 16 Mr. Parvinen testifies as follows:

4 The Commission has also allowed certain pro forma transmission investment related to
5 Avista’s 230kv, five year, upgrade project. The Commission included this project in rate
6 base to promote system reliability. The additions did not increase overall capacity, and any
7 offsets from reduced interruptions and reduced maintenance were demonstrated to be
8 minimal, as compared to the test year. (Emphasis added)
9

10 Even if one were to make the case that there may be some small reductions to O&M or a
11 small increase in revenues associated with some of the rate base additions, it would not be
12 reasonable to exclude the full rate base addition because of a concern that a small offset may occur
13 that has not been accounted for. Even Staff recognizes in the testimony above that it is reasonable
14 to include rate base additions if the offsets are determined to be “minimal.”

15 **Q. In its initial filing, did Avista exclude rate base additions that would have**
16 **offsetting revenues or expenses?**

17 Yes. In Mr. DeFelice’s direct testimony for Avista he explains how the Company analyzed
18 its capital projects for the period through December 2009 to specifically exclude rate base
19 additions that would be offset by other factors. For example, in developing his pro forma capital
20 Mr. DeFelice excluded new distribution investment dedicated to serving new customers. Revenue
21 from the new customers would offset the investment to hook them up, therefore, Avista excluded
22 that new investment from the pro forma rate base additions in this case.

23 Furthermore, Mr. DeFelice and other Company witnesses spent a considerable amount of
24 time in direct testimony explaining the various rate base additions, and the fact that the majority of
25 them are related to reliability of the electrical system and/or replacement of aging equipment.

1 These additions generally have no offsets in the form of increased revenues, reduced expenses, or
2 other factors. Mr. DeFelice explains that in many cases the benefits come in the form of avoided
3 expenses that would be incurred in the future if the investment were not made, i.e., the benefit is
4 not a reduction to existing costs, but an avoidance of increases in current expense levels that would
5 occur if the investment were not made.

6

7 **C. MATCHING PRINCIPLE**

8 **Q. Please explain your disagreement with Staff and other parties regarding their**
9 **application of the “matching” principle.**

10 A. In its testimony, Commission Staff uses the matching principle, in part, as the basis
11 for rejecting rate base additions in the rate case for 2009, and even some for 2008, stating that the
12 proposed rate base additions create a mismatch of revenues, expenses, and rate base related to the
13 use of the 2010 rate period.

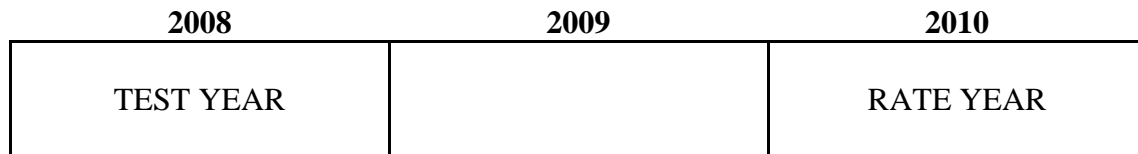
14 With regard to the “matching” principle, the pro forma rate base adjustments proposed by
15 Avista actually understate the costs to Avista to serve its customers during the 2010 rate year. If
16 we were to reflect our true costs to serve customers during the rate year, we would pro form rate
17 base additions through 2010, on an average of monthly average (AMA) basis, and then discount
18 that rate base back to the test year using the production property adjustment. The use of pro forma
19 adjustments together with the production property adjustment preserves the proper “matching” of
20 revenues, expenses and rate base for the test year ratemaking.

21 **Q. Please explain how this matching occurs with the use of pro forma rate base**
22 **adjustments together with the production property adjustment.**

1 A. I will explain it through the use on an illustration. The chart below is a timeline that
 2 illustrates a 2008 historical “test year,” the intervening 2009 year, and then the 2010 “rate year.”
 3 For simplicity in this illustration, each of these years represent calendar years.²

4 **Illustration #1:**

TIMELINE



5

6 In this illustration, the 2008 test year is the starting point for ratemaking, and for rate base,
 7 we start with average rate base for the calendar year 2008 (AMA 2008). AMA rate base is
 8 calculated, in general terms, as the average of the rate base figures for each of the 13 months
 9 December 2007 through December 2008. This average represents the rate base that was providing
 10 service to customers over the course of the test year. It is important to note that rate base is lower
 11 in the first part of the year, and increases over the course of the year as the Company adds utility
 12 investment during the year. From a matching standpoint, for the test year we have average rate
 13 base, total revenue and total expenses for the same period.³ In a general sense, it could be said that
 14 for 2008 we have average rate base, average customers, average customer loads, average revenue,
 15 and average expenses for the same period, thereby ensuring the matching principle.

² In this case, Avista used a test year of 12-months ended September 2008 and a 2010 calendar year rate year. I have used calendar years in my explanation here to simplify the illustration.

³ Rate base, revenues and expenses for the test period are adjusted to reflect “normal” operating conditions through restating adjustments.

1 With respect to rate base, in setting rates for the 2010 future “rate year,” it is necessary to
2 include adjustments (pro forma adjustments) to reflect the rate base additions that will be serving
3 customers during 2010, i.e., the period that new rates from this case will be in effect. Guidance
4 related to these pro forma adjustments includes, but is not limited to, the following:

5 WAC 480-07-510(3)(iii), ‘Pro forma Adjustments’ give effect for the test period to all
6 known and measurable changes that are not offset by other factors.” (emphasis added)
7

8 And again, in the WUTC’s 6th Supplemental Order in Docket No UW-010877, dated July
9 12, 2002, the Commission stated with regard to adjustments to the historical test year, that
10 adjustments will be made:

11 for known and measurable events that will occur prospectively (pro forma adjustments), to
12 best estimate the relationship between the Company’s costs and revenues and thus establish
13 rates that are fair, just, and reasonable and allow the Company the opportunity to earn a fair
14 rate of return. (emphasis added)
15

16 In order for rates during the 2010 rate year to be fair, just, and reasonable, it is essential that
17 all known and measurable rate base additions, that do not have material offsets, be included
18 through pro forma adjustments.

19 **Q. But how do you preserve the matching principle for the test year by including**
20 **the pro forma rate base additions for the rate year?**

21 A. Staff and other parties have apparently overlooked the fact that the “production
22 property” adjustment is specifically designed for the very purpose of adjusting the pro forma rate
23 base adjustments in the future rate year back to the historical test year in order to preserve the
24 matching of customers, revenues, expenses, and rate base during the historical test year.

25 **Q. How does the production property adjustment work?**

26 A. I will use the illustration below, which is the same one that I used above.

Illustration 2:

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TIMELINE

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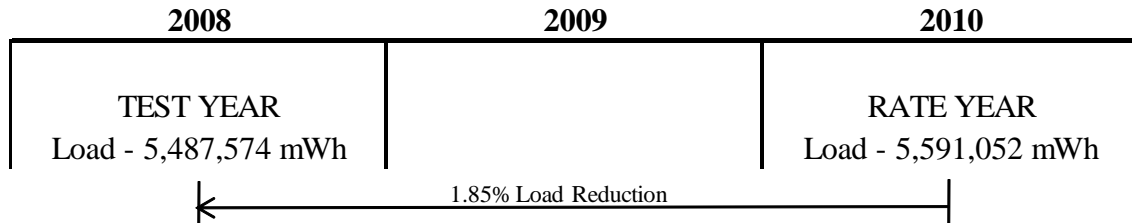
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As explained earlier, in setting retail rates for the 2010 rate year pro forma rate base adjustments should be made to reflect the level of rate base that will be used to serve customers, and customers' kWh load, during 2010. But we know that there will be more customers and higher customer loads (more kWh sales) for the 2010 rate year than the 2008 historical test year.

Because retail rates are set using the lower number of customers and lower customer kWh sales for the 2008 test year, to preserve the matching principle, the pro forma adjusted rate base for the 2010 rate year is adjusted back to the 2008 test year through the production property adjustment.

The production property adjustment is made using a production property factor. The factor is simply one minus the ratio of 2008 test year customer loads divided by the 2010 rate year customer loads. For this rate case for Avista, the 2008 customer loads of 5,487,574 mWh divided by the customer loads of 5,591,052 mWh for the 2010 rate year, results in a production property factor of 1.85%.

The pro forma rate base for 2010 is multiplied by the 98.15% factor to reduce the rate base back to a level that "matches" the level of customers' load for the 2008 rate year, which is used to set rates. The factor is applied to both production and transmission rate base. Retail rates are set to

1 recover less than the 2010 pro forma level of rate base, but as customers' loads grow to the
2 expected level in 2010, the customers' loads in 2010 will provide revenues that "match" the costs
3 associated with the rate base that is used to serve them during the 2010 rate year – a proper
4 "matching."

5 **Q. Has this production property adjustment been supported in prior cases by**
6 **Staff and other parties and approved by the Commission?**

7 A. Yes, and Avista and other parties have included this adjustment in this case, as
8 further explained by Ms. Knox.

9 **Q. Why is it necessary in the ratemaking process to adjust rate base up from the**
10 **2008 test year to the 2010 rate year through pro forma adjustments, and then back from the**
11 **2010 rate year to the 2008 test year?**

12 A. The cost of utility facilities today is much more expensive than in past years. The
13 cost of facilities embedded in retail rates for customers reflects utility investment over the course
14 of many decades. Therefore, the embedded cost of utility facilities in customers' rates is lower
15 than the incremental cost of facilities that will be in place for the 2010 rate year. Thus, the only
16 way for the Company to have the opportunity to recover its costs to serve customers in 2010 is to
17 pro form in the costs to serve them in 2010, and then reduce the level of rate base in 2010 back to a
18 level that matches customers' loads for the 2008 test year.

19 **Q. Is the production property adjustment used in the rate case for costs other**
20 **than rate base?**

21 A. Yes. The production property adjustment is used in the very same way for power
22 supply expenses. Through the testimony on Mr. Kalich and Mr. Johnson they determine the power
23 supply costs necessary to serve customers' loads for the 2010 rate year. Then Ms. Andrews, in her

1 exhibit, discounts the 2010 rate year power supply costs back to the 2008 test year using the
2 production property adjustment, so that there is a proper matching of pro forma power supply costs
3 with the 2008 test year. This is consistent with prior rate cases.

4 **Q. You mentioned earlier that Avista “understated” its costs in this case related to**
5 **rate base additions. Please explain.**

6 A. In our original filing in this case, Avista proposed adjustments to reflect new
7 investment in utility plant (rate base additions) through December 2009. New retail rates from this
8 case will be in place sometime in December 2009, and will remain in place for 2010.⁴ Therefore,
9 the opportunity for Avista to recover its costs of providing service to customers in 2010 is
10 essentially through the retail rates established in this case. We know with certainty that Avista will
11 make additional capital investments in its facilities in 2010, but the retail rates in 2010 will not
12 provide recovery of that new capital investment -- the result is the revenues we receive from our
13 customers in 2010 will not cover, or “match,” the costs to Avista to serve them.

14 If the Commission were to approve the rate base additions only through 2009 as proposed
15 by Avista in this case, there would be a mismatch, but the mismatch would be in the customers’
16 favor. As I explained above, Avista has been conservative and has only included rate base
17 additions through 2009, but none for 2010⁵, and therefore, customers’ rates in 2010 will not
18 include the costs associated with new plant additions in 2010 that will be used to meet their energy
19 needs; as such Avista will continue to experience regulatory lag related to capital additions.

20 If the Commission were to accept Staff’s and Public Counsel’s proposed reductions to rate
21 base, it would further compound the under-recovery of costs for Avista, and would result in the

⁴ Even if Avista were to file a new general rate case in early 2010, an eleven-month procedural schedule would cause new rates from that case to become effective at the end of 2010 or early 2011.

⁵ The only exception is the investment associated with the Noxon Unit 3 upgrade.

1 Company having a substantial amount of utility plant in service serving customers in 2010, but for
2 which customers are not paying the cost.

3 **Q. Why didn't the Company include rate base additions in this case for the**
4 **calendar year 2010 to match the period in which rates will be in effect (the rate year)?**

5 A. As we have already seen in this case, Staff and Public Counsel in their pre-filed
6 testimony have opposed rate base additions not only for 2009, but even some rate base additions
7 for 2008. It was our hope in this case to make good progress toward more timely recovery of new
8 capital investment, and chose to limit the rate base additions to December 2009. As such, it
9 represented a conservative portrayal of rate base. For the majority of these 2009 additions,
10 construction is either already in progress or completed, and all of them will be completed by the
11 time new rates go into effect from this case. Therefore, these completed additions should be more
12 straight-forward to include in retail rates, than the planned rate base additions during the 2010 rate
13 year.

14 **Q. In its testimony, Staff raises concerns about the number and level of pro forma**
15 **rate base adjustments in this case versus prior cases. Do you have any comments on that**
16 **testimony?**

17 A. Yes. Proper pro forma adjustments are not about how many adjustments there are,
18 or how big they are, or whether they have been done before. Proper pro forma adjustments are
19 those that are consistent with the three principles that have been addressed above; "known and
20 measurable," "not offset by other factors," and consistency with the "matching" principle.

21 All of us are seeing differences in this case, and in recent rate cases, that are driven by
22 changes that have occurred in the utility industry. We cannot ignore these changes and hold onto
23 just the mechanics of the way we have done ratemaking adjustments in the past. We must apply

1 the fundamental principles of ratemaking to today's circumstances to ensure that the retail rates
2 that are set are fair, just, and reasonable, and provide the opportunity for the Company to earn a fair
3 return on the capital investment that is put into place to serve customers.

4 Historically, with regard to new utility capital investment, the annual dollars spent by the
5 Company on new utility plant were generally relatively close to the level of annual depreciation
6 expense, with the exception of years where the Company invested in major new utility projects.⁶
7 With that being the case, changes to rate base over time were driven by a few major investments,
8 usually new generating plants or upgrades, which resulted in few pro forma rate base adjustments
9 in a rate case. Today our annual utility capital investment is much higher than annual depreciation
10 expense, due to, among other things, the much higher cost of materials, mandatory reliability
11 requirements, and aging infrastructure which must be replaced or upgraded. The increased capital
12 requirements are spread across the entire spectrum of generation, transmission, and distribution.
13 This will naturally result in more pro forma rate base adjustments to properly reflect in retail rates
14 the costs to serve customers.

15 **Q. Have the rating agencies recognized the increased capital investment**
16 **requirements for utilities, and expressed concerns regarding the timely recovery of this new**
17 **investment?**

18 A. Yes. As an example, when the Company was upgraded by Moody's in December
19 2007, they stated:

20 "(a)t the same time, our rating actions also incorporate the ongoing challenges that we
21 believe Avista still faces given its expected higher capital spending program over the next
22 couple of years. Against this backdrop, Moody's is assuming that the company's regulators
23 in its Washington, Idaho, and Oregon jurisdictions will continue to support timely and
24 adequate recovery of, and return on, the capital investments through decisions in future

⁶ Recognizing that a portion of the costs associated with capital additions are offset by additional revenues.

1 general rate cases that we expect will be filed on a regular basis. In our overall assessment
2 of regulatory risk, the degree of support from the WUTC is more heavily weighted than the
3 degree of support from the other jurisdictions since Washington is the company's largest
4 jurisdiction, by far⁷.”
5

6 **Q. Mr. Kermode referenced the *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-**
7 **060266 and UG-060267, Order 08, as support for Staff’s position that Avista’s proposed**
8 **capital pro forma adjustments are to be rejected. Do you have any comments on this**
9 **testimony?**

10 A. Yes. Mr. Kermode, at page 30, states:

11 In that order the Commission clearly states that extraordinary circumstances are
12 required to depart from fundamental rate making principles. In addition, in the
13 same order, the Commission denies out-of-period adjustments since there was
14 “scant basis upon which to determine...to what extent they may be used and
15 useful”.
16

17 In Dockets UE-060266 and UG-060267, Puget Sound Energy, Inc. (PSE) proposed a new
18 regulatory mechanism to track depreciation expense for transmission and distribution investments
19 it makes between general rate cases. PSE argued it needed the tracker to address regulatory lag.
20 PSE also proposed that a rate base adjustment for post-test period investments would be an
21 acceptable alternative to the tracker mechanism.

22 The Order, at paragraph 37, states,

23 we disfavor and typically avoid single-issue ratemaking and we are careful to preserve so
24 far as is reasonable the “matching principle” that relies on our consideration of all revenues,
25 cost, and adjustments in the context of a test year with a definite ending date. Thus, PSE
26 asks us to approve a novel mechanism that departs from fundamental principles of
27 ratemaking. (emphasis added)
28

29 It goes on to state,

⁷ “Moody’s upgrades Avista Corp.” December 20, 2007

1 It requires extraordinary circumstances to support a departure from fundamental
2 ratemaking principles. In prior cases the Commission has required “a clear and convincing
3 showing that the Company will be denied any reasonable opportunity to earn its authorized
4 rate of return without extraordinary relief.” We have considered the evidence PSE
5 presented concerning attrition in some detail. Our analysis of the evidence leaves us
6 unpersuaded that PSE will suffer earnings attrition as a result of not recovering depreciation
7 on infrastructure investments it makes **between rate cases**. (paragraph 39) (emphasis
8 added)
9

10 Clearly, the Commission was addressing the request for a depreciation tracker when
11 making the statement that the utility would have to demonstrate extraordinary circumstances. I do
12 not believe a utility, in otherwise requesting pro formed capital additions during a rate case
13 proceeding for assets that will be used and useful prior to new rates taking effect, is making a
14 departure from fundamental ratemaking principles, as Mr. Kermode suggests.

15 On the second issue that Mr. Kermode referenced regarding “scant information”, the same

16 Order states:

17 We are more concerned in this case, however, that there is very little evidence
18 concerning the specific plant additions individual parties propose we allow as out-of-period
19 adjustments to rate base or for determining allowed depreciation. FEA, through its witness
20 Ralph C. Smith, is the only party that addressed this issue in its case in chief. Mr. Smith’s
21 testimony, however, does not identify any specific plant additions. Ms. McLain and Mr.
22 Story testified on rebuttal, but offered little more detail than provided by Mr. Smith. Mr.
23 Russell testified briefly on surrebuttal, and Ms. McLain and Mr. Story with similar brevity
24 on sur-surrebuttal. (paragraph 48)
25

26 While these witnesses mention a few major projects by name, they provide far less
27 information than we typically require when evaluating whether to allow additions to rate
28 base even for plant placed in service during the test year. We have **scant basis upon which**
29 **to determine** the prudence of these post-test period investments or to determine whether
30 and to what **extent they may be used and useful**. These determinations should not rest on
31 speculation. (paragraph 49) (emphasis added)
32

33 In sum, the various proposals for out-of-period adjustments come too late in this
34 proceeding and are supported by too little evidence. Nor have the requirements of due
35 process been fully met. Given that, we could not approve these out-of-period adjustments
36 even were we otherwise so inclined. (paragraph 50) (emphasis added)
37

1 Again, the Commission was clearly addressing the lack of information that was provided in
2 that case. It was not making a point that all post-test year additions that a utility may pro form in a
3 general rate proceeding will be automatically suspect, and therefore, should not ever be considered
4 for inclusion in rate base.

5 In our filed direct case, Avista provided extensive information about the projects that were
6 pro formed. Mr. DeFelice provided exhibits listing all of the projects and explained the purpose of
7 these projects. In addition, Mr. Storro and Mr. Kinney expanded on the project information for the
8 generation and transmission projects. During discovery, Avista provided capital project updates on
9 a consistent basis, and also provided specific project costs for each project. I do not believe that
10 Avista provided “scant” information that would prohibit the Commission from including these
11 post-test period additions in rate base.

12 **Q. Mr. Parvinen also referenced *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-**
13 **060266 and UG-060267, Order 08, addressing “regulatory lag”. Do you have any comments**
14 **on this testimony?**

15 A. Yes. Mr. Parvinen, at page 9, states, “In a recent general rate filing by Puget Sound
16 Energy, the Commission confirmed that regulatory lag is an inherent component of the long-
17 standing historical rate making concept and that it has both positive and negative attributes.”

18 The Order addresses regulatory lag and its impact on earnings (attrition) in in the context of
19 the depreciation tracker mechanism. PSE argued the tracker was necessary to reduce regulatory lag
20 on capital investment between rate cases. The Order, at paragraph 39, states, “Our analysis of the
21 evidence leaves us unpersuaded that PSE will suffer earnings attrition as a result of not recovering
22 depreciation on infrastructure investments it makes between rate cases”. If known and measurable
23 ratebase additions and expenses are intentionally excluded from this case, regulatory lag would

1 have a negative attribute, in that rates would be set at a level that we know would not recover the
2 Company's costs of providing service. All pro forma adjustments that are known and measurable,
3 account for offsetting factors, and are matched with the test period through the production property
4 adjustment as appropriate, must be included in rates, in order to achieve rates that are fair, just,
5 reasonable and sufficient.

6 **Q. Would you please summarize your testimony thus far, as it relates to proper**
7 **pro forma adjustments?**

8 A. Yes. The Company's filing is entirely consistent with the following three principles
9 that guide the use of pro forma adjustments:

10 (1.) Should reflect "known and measurable" changes (reasonable estimates are
11 frequently used in the ratemaking process/absolute precision is not – and has not – been
12 required).

13 (2.) Should consider "offsetting adjustments", if any. (One should not assume, as
14 Staff does, that there will always be offsetting revenues or decreases in costs; many
15 expenditures are made for compliance purposes or to otherwise avoid even greater
16 increases in future costs, not to reduce existing costs.) Company witnesses specifically
17 address the "known and measurable" nature of costs and whether there are any "offsets":
18 Generation ((Mr. Storro); Transmission (Mr. Kinney); Distribution (Mr. Howell/Ms.
19 Cummins) and Mr. DeFelice).

20 (3.) Should preserve the "matching principle" to assure that revenues, expenses,
21 and ratebase are appropriately matched for ratemaking. (The agreed-upon Production
22 Property Adjustment accomplishes this). Without appropriate matching, Avista will be
23 deprived of a reasonable opportunity to earn a fair return.

1 In the end, only if the above principles are sensibly applied, will the Company be given a
2 reasonable opportunity to recover its costs necessary to serve its customers. This “reasonable
3 opportunity” is what the Company requests (and the rating agencies examine). If anything, the
4 Company, itself, has been conservative in that regard by only requesting capital additions through
5 the end of 2009, as opposed to proforming through the 2010 rate year.

6 7 **IV. REDUCTION OF ERM SURCHARGE TO OFFSET INCREASE IN RATES**

8 **Q. Do you have any comments regarding Mr. Parvinen’s proposal regarding the**
9 **ERM surcharge?**

10 A. Yes. Starting at page 14 of his testimony, Mr. Parvinen states that the Staff position
11 is to not reduce the current ERM surcharge to coincide with the implementation of the general rate
12 increase, but, rather, to have the surcharge go to zero when the deferral balance reaches zero.
13 Although we do not know precisely when the balance will reach zero, the current estimate is that it
14 would reach zero in February 2010 if the surcharge were to remain in place. The Company
15 believes that the surcharge rate should be reduced at the time of the general rate increase to
16 partially offset the rate impact on customers, and to limit the number of rate changes experienced
17 by customers in a short period of time, especially during the winter months.

18 In our original filing, Avista proposed that the ERM surcharge be reduced to zero at the
19 time new rates go into effect from this general rate case, and any remaining ERM balance would be
20 carried forward and recovered in a future period. In response to Staff’s recommendation, the
21 Company proposes a combination of the Company’s and Staff’s recommendations as follows: 1)
22 at the time the general rate increase is implemented at the conclusion of this case, revise (reduce)
23 the ERM surcharge to recover the remaining deferral balance at that time over a 12-month period,

1 and 2) the reduction of the current ERM surcharge to the lower level would serve to offset a major
2 portion of the rate impact to customers resulting from this general rate case. This approach would
3 not only avoid two rate adjustments to customers in a short period of time during the winter
4 heating season, but would also result in a purposeful reduction of the existing deferral balance to
5 zero in a defined 12-month period.

6 The current estimate of the ERM balance at December 31, 2009 is approximately \$4.5
7 million. The recovery of this balance over a 12-month period would result in an ERM surcharge of
8 approximately 1%, as compared to the current surcharge of 9%. Therefore, recovery of the ERM
9 balance over a 12-month period, based on current information, would allow for a reduction in the
10 surcharge, which would offset a major portion of the general rate increase from this case.

11 **V. DECOUPLING MECHANISM**

12 **Q. Please summarize the recommendations that you set forth in your testimony as**
13 **it relates to the Decoupling Mechanism in response to the testimony of other parties in this**
14 **case.**

15 A. The Company requests that the Commission approve the continuation of the
16 Decoupling Mechanism (Mechanism) including the New Customer Adjustment, and incorporate
17 the requested 101/111 schedule shifting adjustment. Further, the Company would agree to the
18 following additional modifications:

- 19 1. Lower the deferral recovery to where the Company can recover up to 70% of the
20 deferral if 100% of the DSM savings are achieved, instead of the current 90%
21 maximum recovery level.
- 22 2. Add a Limited Income Test, whereby 5% of programmatic DSM savings must come
23 from the Limited Income Sector.

1 3. The Company will work with the Parties to address the Company's measurement and
2 verification of DSM savings, with the results filed with the Commission by September
3 30, 2010.

4 **Q. Do you have any initial observations related to the testimony presented by the**
5 **parties?**

6 A. Yes. Having reviewed the parties' testimony in this matter, for the most part, the
7 parties do not provide a compelling argument as to why the Mechanism should not be continued.
8 The majority of the testimony deals with DSM issues, specifically measurement and verification
9 procedures and limited income energy efficiency savings. Other testimony deals with certain
10 adjustments that are made in the calculation of the deferrals. Finally, arguments are made that the
11 Mechanism is too complicated and time-consuming to administer. In my opinion, none of these
12 arguments address the rationale of the Mechanism or justify its outright termination. The
13 Mechanism removed the disincentive for the Company to expand its natural gas DSM offerings,
14 both through increased programmatic offerings and non-programmatic messaging. The pilot
15 shows that overall the Mechanism works, removes the disincentive for increased DSM activity,
16 allows the Company to recover fixed costs previously approved by the Commission, and therefore
17 should be continued, with certain modifications.

18 **Q. What are the key items that you will address in your rebuttal testimony?**

19 A. Detailed below are what I believe are the seven key items discussed in the parties'
20 testimony, which we will address in our rebuttal testimony:

- 21 1. Recovery of fixed costs beyond programmatic DSM savings
22 2. Has the mechanism led to increased DSM acquisition?
23 3. The Evaluation Of The Decoupling Mechanism, and more specifically the work of
24 Titus

- 1 4. Arguments suggesting the mechanism is too complex and time-consuming to
- 2 administer
- 3 5. New Customer Adjustment
- 4 6. Rate Design issues, specifically Straight-Fixed Variable
- 5 7. Energy Efficiency Measurement and Verification
- 6 8. Limited Income issues
- 7

8 **Issue #1 – Recovery of Fixed Costs Beyond Programmatic DSM Savings**

9 **Q. In his prefiled testimony at Page 13, line 9, Public Counsel witness Brosch**
10 **states that the Mechanism has an “overly broad scope”, in that the Mechanism captures the**
11 **effects of declining use-per-customer beyond the savings resulting from programmatic DSM.**
12 **Does the Mechanism have an “overly broad scope”?**

13 A. No, it does not. The rates established in a general rate proceeding are designed to
14 provide full recovery of the costs of providing service to customers. When the majority of fixed
15 costs are recovered through sales volumes, and sales volumes are lower than expected, the recovery
16 of fixed costs falls short of the level authorized by the Commission. Recovery of just the fixed
17 costs resulting from programmatic DSM savings is just one piece of this, but not the whole picture.

18 The Company believes that the Mechanism, which separates the recovery of fixed costs
19 from sales volumes, is consistent with the ratemaking objective of authorizing rates that are
20 designed to provide the opportunity to recover the fixed costs of providing service, while at the
21 same time aggressively pursuing reduced customer usage through energy efficiency measures
22 (programmatic) and customer education (non-programmatic).

23 **Q. Mr. Brosch and Energy Project witness Ms. Alexander both discuss non-**
24 **programmatic DSM efforts the Company has undertaken, specifically its “Every Little Bit”**
25 **program. Do you believe that this program has led to a declining use per customer?**

1 A. Absolutely. The Every Little Bit website provides extensive information to
2 customers regarding the Company's DSM programs and rebates, as well as low-cost/no-cost steps
3 customers can take to reduce their energy use. This messaging has been reinforced by the general
4 societal push towards energy efficiency and being more environmentally conscious. Mr. Brosch
5 states at Page 20, line 3, that it is “unlikely that such a modestly funded program yields any
6 significant additional therm savings that have not been directly measured”, however he fails to
7 provide any data or analysis to support this point. Ms. Alexander, at Page 4, line 11, states that the
8 Every Little Bit program was an “expensive media campaign” which specifically targets only
9 higher income customers who can participate in the Company’s rebate programs. Ms. Alexander
10 provides no evidence that this is the case.

11 The facts are that the Every Little Bit program does lead to customers undertaking no-cost
12 and low-cost steps towards being more efficient. Adjusting thermostats, replacing dirty furnace
13 filters, turning down hot water tank temperatures, reducing overall hot water usage through shorter
14 showers, installation of low-flow showerheads and aerators, all lead to an overall reduction in
15 natural gas consumption, well beyond that which is specifically measured in the Company’s DSM
16 programs. These efficiency suggestions are all a part of the Home Energy Audit, available at
17 www.EveryLittleBit.com. In 2008, **18,467** customers completed the Home Energy Audit.

18 **Q. Parties note that the Company’s deferrals are six to eight times larger than**
19 **programmatically DSM lost margin. What is the Company’s response?**

20 A. The Company agrees that this is the case. Fixed cost recovery related to
21 programmatic DSM makes up a relatively small component of the deferrals. However, non-
22 programmatic DSM as described above, in my opinion, makes up another meaningful portion of
23 the deferrals. Further, the Company actively participates in various groups and organizations that

1 push for tougher energy codes and standards; the results of which further impact the deferrals. Put
2 more simply, there are many factors that have led to an overall use per customer reduction of
3 natural gas, all of which lead to the fact that the Company is not recovering its fixed costs - costs
4 which were previously authorized for recovery by the Commission.

5 **Q. Should the Company recover lost margin from non-energy efficiency reductions,**
6 **such as the decreasing price of natural gas, the overall decline in the national economy, or**
7 **from customers reducing usage beyond the scope of the Company's DSM programs?**

8 A. Yes. As I mentioned, the Company's rates are designed to provide for the full recovery
9 of costs approved by the Commission. Whether or not customers usage increases or decreases, the
10 Company must still invest in the infrastructure to serve our customers, i.e. natural gas mains,
11 services, meters, etc. Given that the volumetric component of customer's rates is used as the
12 mechanism for the recovery of fixed costs, the Company will not recover fixed costs in a declining
13 use environment.

14 However, the Company is aware that there are variables outside of the normal ebb and flow
15 of customer usage over time. The Company's current mechanism calls for 90% recovery of the
16 Decoupling deferral if 100% of the DSM test is met. The Company agrees, only in part, with
17 NWECA Witness Ms. Glaser, that the recovery levels should be adjusted. The Company proposes
18 the following recovery structure, whereby the Company would only recover 70% of the decoupling
19 deferral instead of 90% assuming that the Company achieves 100% of Target DSM Savings:

20

1

2

Current Mechanism

3

4

5

Actual vs. Target DSM Savings	Amount Deferred
<70%	60%
>80% and <90%	70%
>90% and <100%	80%
100%	90%

6

Proposed

7

8

9

10

Actual vs. Target DSM Savings	Amount Deferred
<70%	40%
>80% and <90%	50%
>90% and <100%	60%
100%	70%

11

12

Q. Parties make the assertion that the Company has been very active in DSM, even in the absence of a decoupling mechanism. Is this true?

13

14

15

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21

A. Yes. As noted by the Parties, the Company has had robust electric and natural gas DSM programs for many years. Further, the Company has ramped up its DSM acquisition not only with its natural gas customers in Washington, but also its natural gas customers in Idaho and Oregon and all of its electric customers. The Company believes that energy efficiency is the right thing to do, but when you are as successful as the Company has been, fixed costs are not recovered. The increased emphasis on DSM by the Company in the last couple of years has been done with the expectation that the Company would have some mechanism to recover fixed costs associated with its DSM efforts. The presence, or lack thereof, of some mechanism for fixed cost recovery is a major factor that will be considered as the Company develops its future DSM plans.

22

Q. What other decoupling mechanisms exist throughout the Northwest?

1 A. The Company continues to monitor the decoupling mechanisms used by other
2 utilities, and the various commissions' support of fixed cost recovery. In summary, it should be
3 noted that most utilities in the Northwest, as well as California, have some form of decoupling:

<u>State</u>	<u>Commission</u>	<u>Utility</u>	<u>Year</u>	<u>Type of Decoupling</u>
California		Sempra, PG&E, SoCal Edison	1978-1982	Electric and Natural Gas
Idaho		Idaho Power	2005	Electric
Oregon		Cascade Natural Gas	2006	Natural Gas
Washington		Cascade Natural Gas	2007	Natural Gas
Oregon		Northwest Natural	2007	Natural Gas
Oregon		Portland General Electric	2009	Electric

4

5 **Q. Public Counsel Witness Mr. Michael Gorman states that if a Mechanism is**
6 **ultimately approved by the Commission, that an ROE adjustment of 25 basis point for**
7 **natural gas should be made due to a reduction in business risk. Do you agree that such an**
8 **adjustment is appropriate?**

9 A. No. The Mechanism does not significantly affect the Company's business risk and
10 an adjustment to the Company's authorized Return on Equity (ROE) is not warranted. The
11 Company's proposed mechanism captures only the change in residential customers' usage resulting
12 from natural gas energy efficiency and other factors on a weather-normalized basis. It does not
13 capture: 1) changes in large customer usage often resulting from changes in business or economic
14 conditions, and 2) changes in customer usage resulting from abnormal weather. These changes in
15 customer usage that are not included in the Company's mechanism can have a greater financial
16 impact on the Company.

17 Furthermore, as noted above, the Mechanism simply provides recovery of fixed costs that
18 were previously approved by the Commission in a prior general rate case for recovery from
19 customers. To the extent those fixed costs increase, or escalate, over time, the Mechanism does

1 not provide recovery of that change in costs. The Company continues to bear the risk of changes in
2 those costs between general rate cases. Finally, the mechanism includes an “earnings-test” - a
3 provision that will not allow the Company to implement a decoupling rate adjustment if its
4 earnings exceed its authorized rate of return.

5 A reduction to ROE of 0.25% would reduce revenues to the Company by approximately
6 \$300,000 per year. The proposed reduction in recovery of fixed costs from 90% to 70% would
7 represent a revenue reduction to the Company in the same order of magnitude. To adopt an ROE
8 reduction together with the percentage reduction from 90% to 70% would substantially undermine
9 the effectiveness and objective of the Mechanism.

10

11 **Issue #2 – Has the Mechanism Led To Increased DSM Acquisition?**

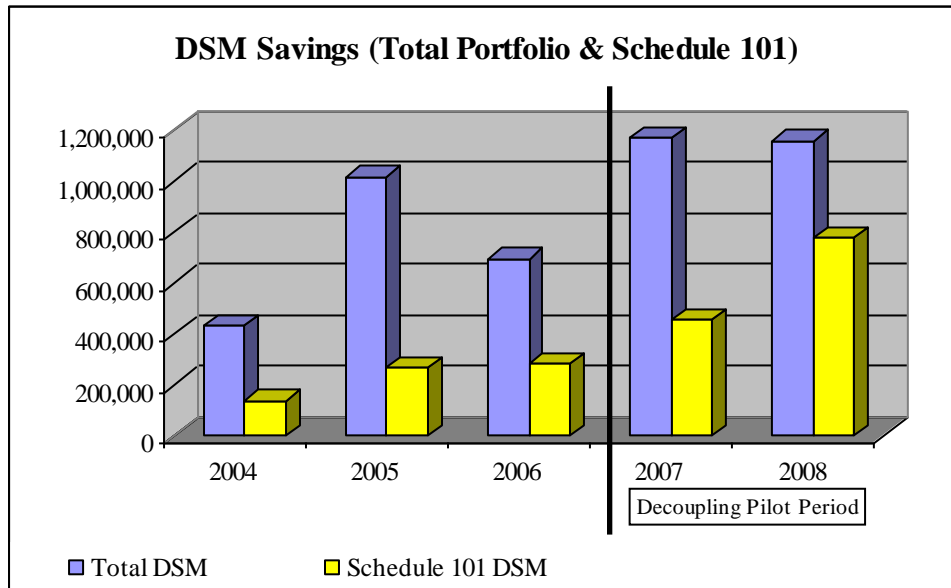
12 **Q. Simply stated, during the term of the Mechanism pilot, did overall natural gas**
13 **DSM acquisition increase?**

14 A. Yes. As stated in Mr. Powell’s rebuttal testimony, overall DSM acquisition
15 increased. When comparing Washington jurisdictional therm acquisition in the pre-pilot period of
16 2004 and 2005 to the 2007 and 2008 pilot period, as shown in Chart 1 below, the Decoupling
17 Evaluation Report, which is Exhibit No. ____ (BJH-2), noted a 61% increase in total Washington
18 therm savings across all rate classes, a 205% increase in therm acquisition in the Washington
19 Schedule 101 class and a 13% increase in the Washington limited income sector⁸.

20

⁸ “Evaluation of Avista Natural Gas Decoupling Mechanism Pilot” Report, Page 3.

CHART 1



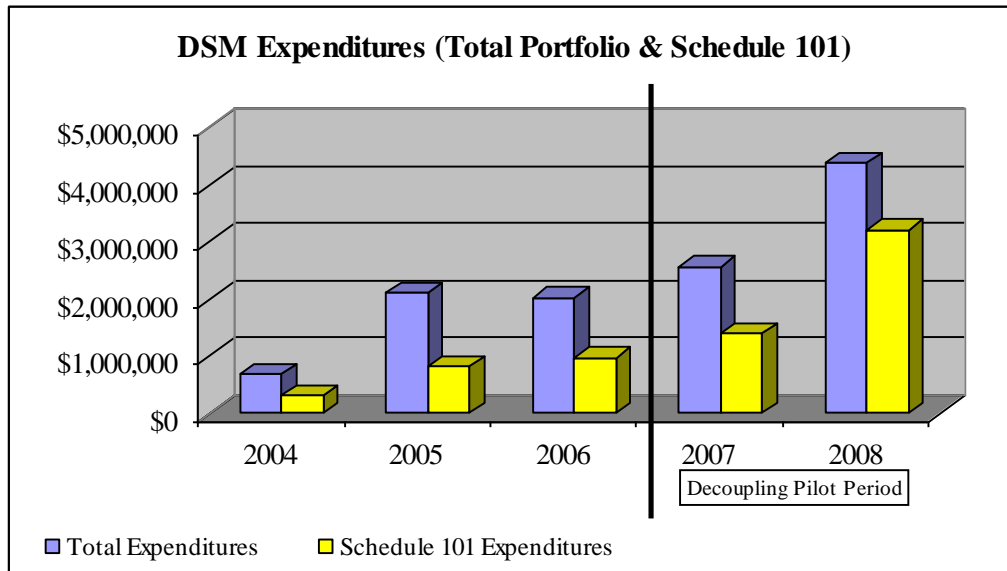
In addition to the increased programmatic DSM savings, the Company also significantly ramped up its non-programmatic efforts. As described earlier in my testimony, the Company launched the Every Little Bit campaign. We believe that this campaign pushed customers to not only participate in our programmatic DSM savings, but more significantly provided the information customers could use to make no-cost and low-cost energy efficiency improvements in their residences.

Q. Was there an increase in DSM costs during this period as well?

A. Yes. The increased therm acquisition came at a higher cost as progressively more expensive DSM resources were acquired, as shown in Chart 2 below⁹. This is a direct consequence of the prioritization of resource acquisition; as the avoided cost of natural gas rises, increasingly costly demand-side resources are acquired. This leads to an overall increase in the average cost of the DSM portfolio.

⁹ Id.

CHART 2



10 **Q. Parties have made the argument that the Company increased natural gas DSM**
 11 **in 2005, well before the Mechanism pilot was approved. Did the Company believe that DSM**
 12 **was important even in the absence of a Decoupling Mechanism?**

13 A. Yes. As stated in my earlier testimony, the Company has had robust electric and
 14 natural gas DSM programs for many years, and is very supportive of energy efficiency. This is
 15 shown not only by the Company's ramp up of natural gas DSM in Washington prior to the
 16 mechanism, but also by continued growth in electric and natural gas DSM offerings for our
 17 customers in other jurisdictions. One reason for the decision by senior management to ramp up
 18 energy efficiency was the expectation that the commissions would provide some form of recovery
 19 of fixed costs related to our DSM efforts. This is why the Company filed for the natural gas
 20 Decoupling Mechanism in Washington in the first place.

21 **Q. Mr. Brosch at Page 10 states that "some states, including Washington, have**
 22 **least cost planning requirements that require acquisition of cost-effective demand side**

1 **resources” implying that the Company must offer DSM programs to meet regulatory**
2 **requirements anyway. Is this true.**

3 A. Yes, the Company does have least cost planning requirements, and as noted in our
4 electric and natural gas Integrated Resource Plans, it does have certain programmatic DSM
5 acquisition targets. These targets though do not include unmeasured DSM savings from the
6 Company’s activities in non-programmatic DSM as well as the continued support for tougher
7 building codes and standards. The disincentive for the Company to push for programmatic DSM
8 above IRP targets, to push for tougher building and appliance codes, and to support non-
9 programmatic DSM programs and messaging is not removed simply because there are
10 programmatic DSM acquisition targets.

11 **Q. What factors influence the natural gas DSM program efforts and acquisition**
12 **by the Company?**

13 A. There are a number of factors that influence the natural gas DSM program efforts
14 and acquisition by Avista such as the cost of the programs themselves, the level of funding
15 available for programs, the impact on retail rates, recovery of costs related to the programs,
16 expectations related to customer participation, and the general level of support from the
17 commissions and other stakeholders, among others. The decoupling mechanism addresses one of
18 the major considerations related to increased DSM acquisition: the fact that retail rates are
19 designed to recover costs based on sales volume, and increased DSM acquisition results in the
20 direct failure by the Company to recover the costs to provide service to its customers. The two
21 features of the decoupling mechanism which were most effective in removing financial
22 disincentives for increasing DSM acquisition and in placing greater management emphasis on
23 DSM acquisition were (a) the recovery of intra-rate case fixed costs related to reduced usage,

1 particularly for the small general use customers and (b) the DSM acquisition tiered trigger
2 mechanism on the recovery of tracked fixed costs.

3 The existence of the DSM acquisition trigger mechanism on the recovery of tracked fixed
4 costs focused departmental performance metrics upon this process. This is evidenced by the
5 creation of new monthly performance tracking statistics specifically related to the achievement of
6 this mechanism. This focus resulted in an increase in the likelihood that the Integrated Resource
7 Plan goal employed as a trigger within the decoupling mechanism was fully achieved. The
8 observed increase in DSM acquisition and activity is consistent with that which would be expected
9 as a consequence of the removal of financial disincentives for DSM success.

10

11 **Issue #3 – Is the Mechanism Too Complex And Time Consuming To Administer**

12 **Q. Public Counsel and Staff argue that the Mechanism is too complicated and**
13 **time consuming to administer. Do you agree?**

14 A. No I do not. The Mechanism is simple and straightforward. To demonstrate its
15 simplicity, the monthly calculation of the decoupling deferral is summarized below:

- 16 1. Determine schedule 101 actual billed therms
17 2. Deduct new customer usage
18 3. Adjust for unbilled therms using previously approved methodology
19 4. Perform “Weather Adjustment” using previously approved methodology
20 5. Subtract test year therms adopted in previous rate case
21 6. Multiply the difference between billed and test year by the margin rate adopted in
22 previous rate case
23 7. Multiply by 90%

24

25 The most complicated calculation is the “Weather Adjustment”, which is the same adjustment that
26 the Company has used in general rate case filings for years, and which has been approved by this
27 Commission.

1 As for the argument that the Mechanism is too time consuming to administer, from the
2 Company's perspective, this does not need to be the case going forward.

3 **Q. Please explain why this does not need to be the case.**

4 A. During the term of the pilot Mechanism, the oversight was very time consuming for
5 all parties. For one thing, that is the nature of a pilot. The time spent by all parties on the
6 Advisory Group both in terms of developing the Evaluation Plan and overseeing the consultant in
7 the development of the final Evaluation, was significant. Perhaps the largest factor driving the
8 consumption of human resources was the fact that this work was done in the face of adamant
9 opposition to decoupling in any form by at least one party. The results from this investment,
10 though, will be of benefit to all parties and this Commission for years to come.

11 Going forward, the time spent evaluating the Mechanism should decrease substantially.
12 The Company would continue to provide reports on a quarterly basis to all parties detailing the
13 accounting deferrals for each quarter. On an annual basis, coincident with the annual PGA filing,
14 the Company would file its proposed decoupling surcharge (or rebate) based on the amount of
15 deferred revenue recorded for the prior July – June period. The results of the “earnings”, “DSM”
16 and “2%” tests are included with the filing and used to determine the amount of the rate
17 adjustment. The analysis of these reports should be simple and straightforward.

18 Also included with that annual filing would be the third-party audited DSM savings. The
19 vast majority of testimony filed in this case regarding the Company's Decoupling Mechanism dealt
20 with the validity of claimed DSM savings. As Company witness Mr. Powell explains in rebuttal
21 testimony, Avista will work with interested Parties in developing acceptable measurement and
22 verification protocols. It should be noted, though, that this collaborative will need to occur
23 whether or not the Mechanism is continued.

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Issue #4 – New Customer Adjustment

Q. Parties argue that the New Customer Adjustment in the Decoupling Mechanism is flawed and is one reason why the Mechanism should not be continued. Do you agree?

A. No I do not. As Company Witness Mr. Hirschorn will discuss in more detail in his rebuttal testimony, the New Customer Adjustment is not flawed, but rather it is a necessary and required component of the Company’s Decoupling Mechanism.

Q. In summary, why do parties feel that this adjustment is flawed?

A. The argument raised, in particular by Mr. Brosch, is that the fixed costs for new customers are substantially below the average fixed costs for all customers. He asserts that with an average fixed cost of \$8.07, and an average margin of \$22.45, existing customers are being harmed when new customers are connected to the natural gas system as the incremental margin flows directly to the Company’s shareholders. As Mr. Hirschorn will show, the average fixed costs for new customers is actually in excess of the average margin received.

Further, if you were to add new customer’s usage to previously existing customer’s usage, and compare that to the test year period’s usage, which did not contain the new customers, the Company would in essence be refunding all margin collected from new customers, which would imply that there are no incremental costs associated with serving new customers.

Q. Staff Witness Ms. Reynolds states that, should the Commission approve the Mechanism, the New Customer Adjustment should be removed. Do you agree?

1 A. No I do not for the reasons stated above. Further, Ms. Reynolds argument that “the
 2 point of the decoupling mechanism is to stabilize revenues for the Company¹⁰” is incorrect. The
 3 point of the decoupling mechanism is to provide recovery of fixed costs previously approved by
 4 this Commission, that are related to the energy efficiency efforts of the Company. The way to do
 5 this is to compare “apples to apples” by removing the usage for new customers added since the test
 6 year. As Mr. Hirschhorn further explains in his rebuttal testimony, if this “apples to apples”
 7 comparison is violated, the effectiveness of the Mechanism would be completely undermined.

8 **Issue #5 – Rate Design Issues (Specifically Straight-Fixed Variable)**

9 **Q. Does the Company agree with Staff witness Ms. Reynolds that moving towards**
 10 **a slightly higher fixed charge of \$8 or \$10 is preferable to a Decoupling Mechanism?**

11 A. No, it does not. As noted earlier, the majority of Avista’s fixed costs of providing
 12 natural gas service are recovered through a rate per therm for each therm sold. Ideally, from the
 13 Company’s perspective, all of the fixed costs of providing service would be recovered through a
 14 fixed charge each month, since the facilities and support services must be available to serve
 15 customers irrespective of how much energy they use. However, that fixed charge would need to be
 16 approximately \$22.45 per month in order to recover the fixed costs of providing gas distribution
 17 service. Mr. Hirschhorn in his rebuttal testimony will provide additional information regarding
 18 this issue. Although the Company believes a higher basic charge of \$8 to \$10 per month is a move
 19 in the right direction and would be appropriate, it would not be a substitute for decoupling.

20 **Q. Would the Company be able to administer a special \$3 basic charge for**
 21 **Limited Income customers as detailed by Ms. Reynolds?**

¹⁰ Reynolds Testimony (DJR-1T) Page 21, line 15

1 A. No, it cannot. Staff's proposal states that those customers that qualify for LIHEAP
2 and LIRAP any time during the program year (October-September) would have a lower monthly
3 charge of \$3. While the concept sounds simple, the administration of such a program would be
4 burdensome, if not impossible, both in terms of computer programming (if even possible with our
5 existing systems), and in terms of manpower. Further, key issues such as whether the lower basic
6 charge is retroactive, add additional complexity. For example, if a limited income customer
7 receives a grant in May, but the \$3 monthly charge is retroactive to the prior October, Company
8 personnel will have to individually review, cancel, and re-bill each customer, for each month that
9 the lower basic charge would be applicable to. Further, the customer would receive revised bills
10 for those prior months which could cause further confusion.

11
12 **Issue #6 – Energy Efficiency Measurement And Verification**

13 **Q. What is the Company's view on the comments from certain parties that the**
14 **Company's measurement and verification was not as vigorous as they might like it to be.**

15 A. Based on what was learned during the Decoupling Mechanism pilot, there is a need
16 for improvement in the area of measurement and verification of DSM savings. These issues,
17 however, are independent of the decision related to the continuation of the Decoupling Mechanism.
18 Improvements to DSM measurement and verification will occur, whether the Decoupling
19 Mechanism is continued or not.

20 As noted in the testimony of Jon Powell in this matter, the Company is in the process of
21 developing a revised measurement and verification approach for review with the September 2009

1 Triple-E board and for incorporation into the 2010 DSM Business Plan¹¹. In addition, the
2 Company, as stated by Mr. Powell in his rebuttal testimony, would convene a group of interested
3 parties to outline the proper measurement and verification protocols going forward. With these
4 revised protocols in place, issues around measurement and verification should be satisfied.

5 **Q. When is the Company proposing to file the results of the measurement and**
6 **verifications protocol with the Commission?**

7 A. No later than September 30, 2010.

8

9

Issue #7 – Limited Income

10 **Q. Did the Company increase overall energy efficiency program offerings for**
11 **Limited Income customers?**

12 A. Yes. As noted in Company witness Mr. Powell’s prefiled testimony, the limited
13 income customer base saw a 13% increase in DSM savings during the period, with a 43% increase
14 in expenditures. The Company understands that the increases in savings and expenditures are not
15 in line with the other segments – residential and commercial/industrial. Mr. Powell in his rebuttal
16 testimony will describe in more detail why this class of customers saw less of an increase in DSM
17 savings relative to the other segments. Simply put, though, Ms. Alexander’s statement at Page 14
18 that “there is no evidence that the decoupling program or mechanism had any impact on Avista’s
19 design, funding, or implementation of DSM programs targeted to limited income customers” is
20 unfounded.

21 **Q. What was the average Decoupling Deferral for limited income customers**
22 **during the pilot period? How about for DSM programs?**

¹¹ Powell Testimony (JP-1T), Page 8

1 A. The three year average decoupling deferral for limited income customers was \$4.74,
2 or \$0.40 per month. The average annual impact of the DSM surcharge is \$10.05, or \$0.84 per
3 month¹².

4 **Q. Did the Decoupling Mechanism have a financial impact on limited income**
5 **customers?**

6 A. Yes, on a net basis there was a benefit to that customer group. Mr. Powell will
7 provide a more detailed explanation of this net benefit. Suffice it to say, the Limited Income group
8 as a whole benefited from the investments in energy efficiency projects by more than the
9 Decoupling and DSM surcharges combined.

10 **Q. NWECA witness Ms. Glaser states that there should be two DSM tests for the**
11 **Decoupling Mechanism, the existing DSM test as well as a new Limited Income DSM Test. Is**
12 **the Company supportive of an additional test?**

13 A. Yes, the addition of the Limited Income test is agreeable to the Company. Avista
14 has had a long track record of providing DSM for our limited income customers, primarily through
15 various Community Action Partnership (CAP) agencies. Mr. Powell, in his rebuttal testimony, will
16 provide more detail on how we work with these partners for the delivery of energy efficiency
17 services.

18 One item to note, though, is that Ms. Glaser does not clearly define the mechanics of the
19 proposed test. As such, the Company suggests the following test:

20

¹² "Evaluation of Avista Natural Gas Decoupling Mechanism Pilot" Report, Page 83 (Table K11-C).

1

Proposed	
<u>% of Natural Gas DSM Savings from LI Sector</u>	<u>Amount Deferred</u>
5% or higher	100%
>4% and <5%	90%
>3% and <4%	80%
3% or less	70%

2

3 As Mr. Powell notes in his rebuttal testimony, the control over the acquisition of savings from the
4 limited income sector falls on the CAP agencies, and not the Company. As such, the limited
5 income DSM test cannot be a true all-or-nothing test, as the Company can provide only so much
6 guidance in the acquisition of therms. The Company provides the agencies with as much
7 flexibility as possible when working with their constituents, allowing them to allocate funds to the
8 most critical areas. In some instances, this allocation leads to more electric DSM acquisition than
9 natural gas.

10 **Q. Please describe then the mechanics of the Decoupling Mechanism with this new**
11 **Limited Income test?**

12 A. The Decoupling Mechanism would have a two-trigger DSM test. The first trigger
13 would be the DSM test, i.e., at what level did the Company meet or fall short of its IRP DSM
14 savings targets. With our revised proposal of a 70% maximum deferral recovery, and assuming the
15 Company met or surpassed its IRP goal, a 70% recovery would be the result. Next, the percentage
16 of savings from Limited Income customers would be analyzed. For illustrative purposes only, let's
17 assume that only 4.5% of DSM savings came from Limited Income customers. Instead of
18 recovering 70% of the deferrals under the existing mechanism, the Company would only recover
19 63% of the deferrals ($70\% * 90\% = 63\%$).

1 **Q. Mr. Brosch states that the Commission should deny the Company’s request for**
2 **a Decoupling Mechanism, and in its place substitute a DSM incentive mechanism. Is the**
3 **Company supportive of this notion?**

4 A. The Company would agree that a DSM incentive mechanism is desirable, but only
5 in addition to, not in lieu of, a decoupling mechanism. The purpose of an incentive mechanism is
6 to drive the Company’s DSM acquisition performance. The purpose of a decoupling mechanism is
7 for the recovery of fixed costs resulting from decreased use per customer. The Company believes
8 both mechanisms are important and would be willing to discuss some form of incentive
9 mechanism with interested parties.

10 **Q. In summary, what is the Company requesting from the Commission related to**
11 **Decoupling?**

12 A. The Company requests that the Commission approve the continuation of the
13 Mechanism, including the current New Customer Adjustment, and including the 101/111 schedule
14 shifting adjustment. Further, the Company agrees to the following modifications:

- 15 1. Adjust deferral recovery to that described above, i.e. the Company would recover up to
16 70% of the deferral if 100% of the DSM savings are achieved.
- 17 2. Add a Limited Income Test, whereby 5% of programmatic DSM savings must come
18 from the Limited Income sector.
- 19 3. The Company will work with the Parties to address the Company’s measurement and
20 verification of DSM savings, with the results of such meetings filed with the
21 Commission by September 30, 2010.

22 **Q. Does this conclude your rebuttal testimony?**

23 A. Yes.