Exhibit No. ___(BWF-1T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-07_____

DOCKET NO. UG-07_____

DIRECT TESTIMONY OF

BRUCE W. FOLSOM

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

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

A. My name is Bruce Folsom. I am employed by Avista as the Senior Manager of Demand Side Management (DSM). My business address is East 1411 Mission Avenue, Spokane, Washington.

Q. Would you please describe your education and business experience?

A. I graduated from the University of Washington in 1979 with Bachelor of Arts and Bachelor of Science degrees. I received a Masters in Business Administration degree from Seattle University in 1984.

I joined the Company in 1993 in the State and Federal Regulation Department. My duties included work associated with tariff revisions and regulatory aspects of integrated resource planning, demand side management, competitive bidding, and emerging issues. In 2002, I was named the Manager of Regulatory Compliance which added responsibilities such as implementing the Federal Energy Regulatory Commission's major changes to its Standards of Conduct rule. I began my current position in September of 2006. Prior to joining Avista, I was employed by the Washington Utilities and Transportation Commission beginning in 1984, and then served as the Electric Program Manager from 1990 to February, 1993. From 1979 to 1983, I was the Pacific Northwest Regional Director of what is now the Environmental Careers Organization, a national, private, not-for-profit organization.

Q. What are your current responsibilities at Avista?

A. The DSM Team implements the Company's existing twenty-one DSM programs. In addition to providing these services to customers, we have been asked by Avista's leadership

to enhance these programs and assist with the expansion of the Company's load management and transmission and distribution efficiencies. The eighteen members of Avista's demand side management team consists of program managers, engineers, analysts, and supporting staff. In addition, eight account executives work with our commercial and industrial customers to generate participation in our DSM programs.

Q. Have you previously testified before this Commission?

A. Yes. I have testified before this Commission in over 20 dockets.

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

A. I present three items related to demand side management. First, I provide an overview of the Company's DSM programs and plans for expansion. Second, I propose a modification to the accounting and regulatory treatment of DSM. Third, I provide documentation showing that Avista's expenditures for electric and natural gas energy efficiency programs have been prudently incurred.

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

A. Yes. I am sponsoring Exhibit Nos. ___(BWF-2), ___(BWF-3), and ___(BWF-4) prepared under my supervision and direction. Exhibit No.___(BWF-2) illustrates proposed fixed cost (lost margin) amounts. Exhibit No. ___(BWF-3) is a spreadsheet depicting anticipated future electric and natural gas DSM tariff rider levels. Exhibit No. ___(BWF-4) documents the results and cost-effectiveness of Avista's DSM programs. I will explain these exhibits later in my testimony.

II. DSM PROGRAMS AND EXPANSION

Q. Would you please provide a brief history of Avista's DSM programs?

A. Yes. The Company has a tradition of successful energy efficiency programs beginning as early as 1978 with a focus on wrapping hot water tanks and home weatherization. In 1992 rebates were given to customers that converted space and water heating equipment from electric to natural gas. In 1995 the Company pioneered the country's first non-bypassable distribution charge to fund electric and natural gas energy efficiency programs. Thereafter, this funding mechanism was adopted by many states and utilities.

When the Western Energy Crisis hit, the Company responded with additional programs and enhanced incentives for quicker completions. In six months, three times the expected annual savings were achieved at twice the cost. During this period, the cost-effectiveness level for the Company's DSM efforts was raised to take into consideration record wholesale market prices (which were greater than $200/MWh and over six times the historical cost). During this period the Company invested $12.4 million more in DSM than was collected from customers through the tariff rider. Over the next five years this balance was recovered by applying approximately 35% of tariff rider revenue to the outstanding negative balance. This aggregate balance (two jurisdictions, two fuels) was zeroed out in August of 2005.

The Company offers incentives for all cost-effective commercial/industrial efficiency measures with a pay-back of greater than one year. This is done through two categories of programs, "prescriptive" and "site-specific." Prescriptive programs are "standard offerings," or a menu of rebates on selected measures (e.g., lighting and motors). Site-specific programs are

more customized to the customer premise. For the residential program, all measures are prescriptive.

Q. What is the Company's involvement in regional energy efficiency efforts?

A. In addition to the prescriptive and site-specific measures, the Company funds and participates in the activities of the Northwest Energy Efficiency Alliance (NEEA). NEEA focuses on using a regional approach to obtain electric efficiency through the transformation of markets for efficiency measures and services. An example of NEEA-sponsored programs that benefits Avista customers is decreasing the cost of compact fluorescent light bulbs (CFLs) and high-efficiency appliances by working through manufacturers. For some measures a large-scale, cross-utility approach is the most cost-effective means to achieve energy efficiency savings.

NEEA has proven the efficacy of market transformation in delivering cost-effective energy-efficiency to the market. This approach seems particularly effective for markets composed of large numbers of smaller usage consumers, such as the residential and small commercial markets. The Company has an interest in working with other regional natural gas utilities to apply these market transformation tools to natural gas markets. While the initial efforts in this area are likely to be funded on an ad hoc basis, the ultimate objective is a permanent agreement among regional gas utilities to investigate, develop, and implement gas-efficiency measures.

Q. What is your assessment of the Company's breadth of DSM programs?

A. The Company's energy efficiency offerings have been thorough and comprehensive. This comprehensiveness of Avista's DSM programs is reflected in Table 1, below:

Table 1 -- Current Avista Energy Efficiency Programs	
Residential/Limited Income	**Commercial/Industrial/Institutional**
High-efficiency natural gas furnaces/boilers	Site Specific (any measure)[1]
High-efficiency heat pumps	Efficient lighting and occupancy sensors
High-efficiency variable speed motors	Food service equipment
High-efficiency water heaters	Rooftop HVAC maintenance (AirCare Plus)
Electric to natural gas heat	Variable frequency drives
Electric to heat pump	LEED certification
Electric to natural gas water heaters	Multi-family, replace electric DHW with gas
Ceiling/attic, floor and wall insulation	Premium efficiency motors
Windows	Supermarket and grocery store refrigeration
Limited income measures including health/safety	Power management for computer networks
	LED traffic signals
	Refrigerated warehouses
	Efficient spray head installation

[1]The Site Specific program is an all-encompassing offer to provide incentives on any cost-effective commercial and industrial energy efficiency measure. This is implemented through site analyses, customized diagnoses, and incentives determined for savings generated specific to customers' premise or process.

Q. Is the Company looking at expanding its efficiency efforts?

A. Yes, the leadership of Avista has requested that all efficiency acquisition options—on the customer side of the meter as well as on the Company's side—be re-examined. The Company's 2005 Integrated Resource Plan shows a need for a large baseload generated facility in the next ten years. We are also looking at serving critical peaks in the winter and summer at prices that reflect a higher cost thermal peak generating cost environment. Avista will examine all sustainable, cost-effective efficiencies in an effort to delay the need for new generating facilities.

Q. How is the Company pursuing this directive?

A. We are in the process of comprehensively reviewing our demand response initiatives. Called the Heritage Project, we are examining and implementing expanded energy

efficiency programs, peak shaving/shifting programs, and other options such as transmission and distribution efficiencies.

This is a three-pronged approach that: (1) focuses on our current DSM targets while assessing best practices for program expansion, (2) builds on the Company's legacy of education, outreach, and innovation on customers' behalf, and (3) acquires optimal energy and demand savings in a manner that is sustainable and fiscally sound.

We have created five task forces, or internal working groups, to address this. These task forces represent Energy Efficiency, Load Management, Transmission and Distribution, Analytics, and Communication and Outreach.

Q. Would you first speak to the traditional energy efficiency expansion?

A. Yes. As part of the Energy Efficiency Task Force's efforts, the Company identified an inventory of potential energy efficiency programs and offerings. This was conducted through multiple analyses, including trade ally data, literature search, vendor research and consultant review. Programs and measures were screened based on cost-effectiveness, savings potential, time to implement, implementation costs, and market potential. This led to the projects selected for roll-out in 2007, either as measure enhancements to existing programs or as new programs. The programs to be implemented in 2007 are shown in the following table.

Table 2 -- Proposed New Energy Efficiency Programs		
Start Time	**Residential & Small Commercial/Industrial**	**Commercial/Industrial/Institutional**
1Q07	• Res & Small C&I Quick Hits Program – Fireplace Dampers • Commercial Refrigeration RFP • Multi-family Housing RFP	• C&I Quick Hits Program – Side-Stream Filtration – Energy/Heat Recovery Ventilation (ERV/HRV) – Demand Control Ventilation (DCV) – Steam Traps
2Q07	• Super Efficient Habitat for Humanity (HFH) Homes	
3Q07	• Geographic Saturation Program • Something for Everyone Program	• Retro-Commissioning Program • Behavioral Program
4Q07	• Regional Natural Gas Market Transformation Program	• Facilities Model Program (ongoing)

Q. What are some of your plans for load management?

A. The Load Management Task Force has identified several projects for 2007 implementation. The purpose of these programs is to test technology, customer acceptance, and cost-effectiveness. Examples of planned load management programs are as follows.

- Residential Demand Response Pilot – This pilot will include the installation of "smart" communicating thermostats at specified locations. Other customer features may be examined to test customer responsiveness.

- Small Commercial Demand Response Pilot – The installation of wireless dimmable ballasts and/or other technology in small commercial premises will be the focus of this pilot.

- Large Commercial/Industrial Interruptibility – Agreements with larger commercial/industrial customers to curtail during specific events have proven to be successful. This project would expand and formalize the process to include prearranged structured agreements. These agreements could be handled on a buy-back basis in the near-term and on interruptible rate schedules over the long-term.

Q. Please summarize your plans for Transmission and Distribution (T&D) efficiencies?

A. The T&D team is currently examining the Company's distribution system along with present design practices in order to reduce energy losses caused by equipment on the Avista system. For example, the use of a transformer to increase or decrease the voltage of electricity causes energy losses in the process. For the distribution system there are two areas being examined: 1) altering existing systems to reduce losses, and 2) designing new facilities to minimize losses. Several potential projects are being analyzed based on the present forecasted cost of power, the loss savings and the cost of the improvements.

Q. How are the DSM, demand response and T&D projects being measured for cost-effectiveness?

A. Cost-effectiveness is based on unique circumstances affecting each area. For example, energy efficiency is based on the avoided cost of a baseload plant or purchase. Load management focuses on the cost of peaking resources and T&D is compared to other capital projects with adders. The adders include risk factors such as emissions, volatility, T&D losses, and capacity values.

III. MODIFICATION TO EXISTING ACCOUNTING TREATMENT

Q. Is the Company proposing a change to its regulatory and accounting treatment for DSM funding?

A. Yes. The Company is proposing that DSM accounting be modified from an expensed-only mechanism to a combination of capitalizing and expensing. Under the existing DSM tariff rider, Avista expenses energy efficiency costs on a current year basis and matches revenues collected under Schedules 91 and 191. The Company is proposing that DSM costs be capitalized with carrying charges (i.e., "allowance for funds used conserving energy") and a

predefined minimum capital budget level, as described below, together with electric fixed cost recovery. The DSM tariff riders, Schedules 91 and 191, would continue to provide funding for recovery of the return of and return on the Company's investment in DSM.

Q. What is the rationale for this modification?

A. DSM, if it is to compete on an equal footing with generation resources, should be treated equally. That is, the investment in DSM should be equally attractive to investors as would be an investment in generating resources. Although Avista's proposed modification in this case would still render DSM a less attractive investment than generating resources, it would represent a substantial improvement.

The Company's proposal would also better match customer revenues to fund DSM with customer benefits. Under the existing DSM tariff rider, customers pay in one year for benefits that will continue to provide savings for fifteen or twenty years. This intergenerational inequity is removed under the Company's proposal and provides a better match of customer costs and customer benefits over time.

Q. Wasn't Avista the originator of the DSM tariff rider and what has changed to cause Avista to propose a modification?

A. Yes. Avista historically has been at the forefront of DSM. The Company pioneered the DSM tariff rider in 1995. Before this, the Company was an early adopter of carrying charges for DSM or "funds used conserving energy" (FUCE) accounting in the late 1980s, which removed an identified disincentive to fund conservation. In 1992, the Company received approval for lost margin, or fixed cost, recovery for specific programs.

The DSM tariff rider was the right mechanism at the time. In the early- to mid-1990s, electric industry restructuring was perceived to be inevitable. Therefore, utilities across the country were significantly reducing their energy efficiency budgets so that their power costs could compete with third party power marketers not "burdened" by conservation costs. By creating a non-bypassable distribution charge, the competition problem was solved. All customers, including those who might be served by a third party marketer, would contribute to—and receive the benefit of—conservation. The tariff rider also met "Wall Street's" concern about having a regulatory asset on the books in a restructured industry environment and continued the provision of a base amount of DSM funding. The latter was particularly important when the Western Energy Crisis hit. Avista was able to quickly ramp up its programs at that time due to a strong platform in place.

The current times are very different than those in the early- to mid-90s. Deregulation is no longer on the forefront. Utilities are in the process of planning major generation additions to meet future energy needs. The Company's proposal is tailored to improve the attractiveness of DSM as a "resource" option.

Q. What makes DSM a less attractive "resource" alternative as compared to other resources?

A. DSM is expensed and thus there is no earnings opportunity associated with this cost. Generating alternatives provide for a return of and a return on investment. Furthermore, success in achieving savings leads to reduced recovery of fixed costs between general rate cases.

Q. Please describe the component of the Company's proposal regarding a predefined minimum capital budget level?

A. A benefit of the DSM tariff rider was to remove it from the internal capital budgeting process. Removing DSM from this process provided an ongoing and consistent amount of energy efficiency funding from year to year. To recognize and address this issue, the proposed modification establishes a base amount of DSM funding at current levels, or a "predefined minimum capital budget level," adjusted for contemplated increases in the Company's capital budgeting process. The base level may be exceeded but not reduced, without Commission approval. This proposal would have the effect of a continued stable level of funding to support DSM.

Q. Why is the Company proposing an electric fixed cost recovery (lost margin) component?

A. As I stated earlier, with more focus placed on gaining greater efficiencies, we need to move towards equal financial treatment of generating and conservation investments. Providing electric fixed cost recovery for cost-effective energy efficiency is one step in this direction. Similar treatment is not proposed for natural gas energy efficiency due to the Commission's approval of natural gas decoupling in Docket No. UG-060518.

Q. What is the Company's proposal for fixed cost recovery?

A. The Company's electric fixed cost recovery proposal is based on the fixed costs by service class which range from 0.5 cents/kWh for Schedule 25 customers to 3.0 cents/kWh for Schedule 11 customers. With Washington-jurisdictional savings of over 37,000 MWh attributable to the Company's energy efficiency programs, a $539,000 fixed cost adjustment is estimated for 2008, and subsequent years would reflect the then-current amount. This calculation is shown in Exhibit No. ___(BWF-2).

The Company's fixed cost proposal is not an "incentive" for meeting or beating targets; rather it provides for recovery of fixed costs that would no longer be recovered by the Company due to aggressively pursuing end-use efficiencies on customers' behalf. As described in the following section, a measurement and evaluation procedure to objectively tabulate saved kilowatt hours is already in place. This process has been used by the Commission since 1995 to review prudence and cost-effectiveness of achieved energy savings.

Q. What would be the impact of the Company's proposed DSM modifications to the tariff rider rates in this case?

A. Under the Company's proposal there would be no change to the electric DSM tariff rider at this time. The electric tariff rider would remain at the current Schedule 91 rate to recover the expected Washington electric $3.8 million 2007 year-end deferrals and to provide funding for the return of and return on new DSM investment and fixed costs.

Exhibit ___(BWF-3) shows the estimated amounts to be collected in the electric and natural gas tariff rider going forward under this proposal. Specifically, this depicts capitalizing estimated DSM expenditures to recover the annual revenue requirement through the tariff rider, based on a ten-year amortization for DSM expenditures, budgeted expenditures for 2007, and annual amounts escalated by 5%. This shows that the current electric tariff rider level would be maintained for three years, while there may be an opportunity to reduce the natural gas rider tariff next year. The Company will revisit changes to the natural gas tariff rider in 2008. About the time that the electric DSM deferrals are eliminated in 2010, the annual revenue requirement for DSM would cause an increase in the tariff rider of approximately 0.3% per year.

Q. What FERC Accounts would be used for this proposed accounting modification?

A. To record capitalized DSM expenditures, the amounts would be charged to Account 182.3 - Other Regulatory Assets. Amortization would be recorded by charging Account 407.3 - Regulatory Debits and crediting Account 182.3.

Q. Please summarize the Company's proposal.

A. To improve the attractiveness of DSM as a "resource" option and place it on a more equal footing with generating plant, Avista is proposing that DSM accounting be modified from an expensed-only mechanism to a combination of capitalizing and expensing as follows.

- DSM expenditures be capitalized effective January 1, 2008,
- FUCE carrying charge calculated on unamortized balance, and
- amortized over a ten-year life.

Schedules 91 and 191 would include:

- recovery of deferrals accumulated through December 31, 2007,
- carrying charges (i.e., "funds use conserving energy"), and
- electric fixed cost recovery.

IV. PRUDENCE OF INCURRED DSM COSTS

Q. Would you please explain the Company's request for a finding of prudence in this case?

A. Yes. The Company's electric energy efficiency revenues are collected under the Schedule 91 tariff rider, and its electric programs are offered through Schedule 90. Natural gas energy conservation is funded by revenues collected through Schedule 191 and programs are offered under Schedule 190.

The Commission's approval of the Energy Efficiency Tariff Rider in Docket Nos. UE-941377 and UG-941378 requires that the Company demonstrate the prudence of the Company's energy efficiency expenditures at the time of a general rate case. In Docket Nos. UE-050482 and UG-050483, the electric energy and natural gas efficiency expenditures from the previous general rate case through December 31, 2003 were reviewed for prudence.

In this case, the Company is requesting a finding that electric and natural gas efficiency expenses from January 1, 2004 through December 31, 2006 were prudently incurred.

Q. Would you please summarize the Company's energy efficiency-related programs for the period January 2004 through December 2006?

A. Yes. The Company's tariff riders under Schedules 91 (electric) and 191 (gas) are system benefit charges to fund energy efficiency. The electric energy efficiency tariff rider is an amount equal to approximately 1.50% of retail base rates to all rate classes. The natural gas tariff rider was raised from 0.50% to 1.7% in 2006. The increase in 2006 was to reflect increased demand by customers for energy efficiency services.

The tariff rider and the corresponding energy efficiency programs have been very successful. During the 36 months of electric DSM program activity for which the Company is requesting a finding of prudence, over 139 million kWh of energy savings were obtained. During the 36 months of natural gas DSM program activity for which the Company is requesting a finding of prudence, over 3 million therms of energy savings were obtained. Page 1 of Exhibit No. __(BWF-4) details the energy savings by regular and limited-income portfolios for both electric and natural gas DSM programs.

Q. How are the energy efficiency programs organized?

A. The Company's approach focuses on educating the customer about the benefits of energy efficiency, providing a third party review, and outlining potential savings of the project. The Company's commercial/industrial programs provide assistance to any energy efficiency measure that demonstrates a quantifiable energy saving kWh or therm with a simple payback of greater than one year. Energy efficiency measures that are most commonly implemented include lighting, heating and ventilation equipment, air conditioning, insulation and premium efficiency motors. Many types of industrial process improvements that are unique to a customer's site (e.g. dry kiln fans), as well as compressed air, refrigeration, and controls are also incorporated into the program mix.

Rebates are also offered for a variety of residential measures. The measures include high efficiency electric furnace and water heaters, high efficiency natural gas furnace and water heaters, heat pumps, insulation for both electric and natural gas heated homes and electric to gas conversions. The Company contracts with local Community Action Agencies to assist limited income customers with implementation of many of the same measures as the Residential Portfolio, as well as any additional health and human safety improvements limited to no more than 15% of the amount of conservation upgrade necessary for the home. The Company is also a member of the Northwest Energy Efficiency Alliance (NEEA) and participates in the regional market transformation programs that are developed through that organization.

Q. What is the amount of rebates provided by the Company?

A. During the years 2004 through 2006, over $18.5 million in electric and natural gas rebates were provided to customers. Of the Company's revenues of $27.4 million collected under Schedules 91 and 191 during this time period, 68% was paid out to customers in direct

incentives pursuant to the cost-effectiveness tests described below. This does not include additional benefits such as technical analyses provided to customers by the Company's DSM engineering staff.

Q. What customer classes can benefit from these programs?

A. The Company's programs are delivered across a full customer spectrum. Virtually all customers have had the opportunity to participate in the program offerings. All customers have indirectly benefited through enhanced cost-efficiencies as a result of this portfolio.

For example, Avista has worked in cooperation with governmental entities such as Washington State University, the Spokane Community Colleges, School District 81 and the Washington Department of General Administration and others to secure cost-effective energy savings that directly benefit not only those specific parties, but also benefit all customers by serving load at costs less than new generation. Residential customers have received direct benefits through a broad array of well-received electric and natural gas energy-efficiency programs.

Q. Has there been ongoing review of the Company's programs?

A. Yes. The Company has regularly convened a stakeholders forum known as the External Energy Efficiency Board. These meetings have included customer representatives, Commission staff members, and individuals from the environmental communities. These stakeholder meetings have reviewed each program as well as the underlying cost-effectiveness tests and results.

Q. Has the Tariff Rider had any impact on the normalized level of Company earnings for its Washington jurisdiction?

A. No. The revenue generated by the Tariff Rider has a matching expense associated with it. The bottom line, or net operating income impact is zero, so there is no earnings impact. The actual management of the program disbursements is done through a balance sheet account.

Q. Have the Company's DSM programs been cost-effective?

A. Yes. The programs have been cost-effective from both a Total Resource Cost (TRC) and Utility Cost Test (UCT) perspective. Page 2 of Exhibit No.__(BWF-4) shows that the TRC benefit-to-cost ratio for the overall electric DSM program portfolio is cost-effective, with a net TRC benefit to customers of almost $24 million. The UCT benefit to cost ratio is cost-effective with a net UCT benefit of nearly $40 million. The levelized TRC and UCT cost is 4.6 cents and 1.3 cents per kWh, respectively, for a weighted average measure life of 18.62 years. The comparable electric avoided cost is about 4.8 cents per kWh. The electric DSM programs were also cost-effective under the Participant Test.

Page 3 of Exhibit No. __(BWF-4) illustrates that the natural gas DSM program portfolio is cost-effective under both the TRC and UCT tests. The natural gas DSM programs are cost-effective with a 1.0 TRC benefit/cost ratio. The UCT benefit to cost ratio is cost-effective with a net benefit of over $13.6 million. The levelized TRC and UCT cost is 62.4 cents and 18.0 cents per therm, respectively, for a weighted average measure life of 20.83 years. The comparable levelized avoided cost per annual therm is approximately 60 cents and 65 cents per winter therm using the most recent natural gas avoided costs. The natural gas DSM portfolio passes the Participant Test.

Q. Please summarize the Company's conclusions.

A. The Company's expenditure of tariff rider revenue has been reasonable and prudent. During the time period that the Company is requesting a finding of prudence, a portfolio of 21 programs covering all customer classes have been offered with a total savings of over 139 million annual kWhs and 3 million therms at cost-effectiveness levels described above.

The Tariff Rider and programs have been very successful. Participating customers have benefited through lower bills. Non-participating customers have benefited from the Company having acquired lower cost resources as well as maintaining the energy efficiency message and infrastructure for the benefit of our service territory.

Pursuant to prior Commission authorization of Schedules 91 and 191, Avista respectfully requests that the Commission issue a finding of prudence for energy efficiency expenditures from January 1, 2004 through December 31, 2006.

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

A. Yes, it does.