BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NOS. UE-050482 AND UG-050483

REBUTTAL TESTIMONY OF

DON M. FALKNER

REPRESENTING AVISTA CORPORATION

CONTENTS

I. INTRODUCTION

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

A. My name is Don M. Falkner. My business address is 1411 East Mission Avenue, Spokane, Washington. I am employed by Avista Corp., doing business as Avista Utilities ("Avista" or "Company") and my current position is Manager of Revenue Requirements in the Department of State and Federal Regulation.

Q. Have you previously provided direct testimony in this Case?

A. Yes. My testimony covered accounting and financial data in support of the Company's need for the proposed increase in rates. I explained pro formed operating results including expense and rate base adjustments made to actual operating results and rate base.

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

A. Yes. I am sponsoring Exhibit No.___(DMF-5), which was prepared under my supervision and direction.

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

A. My rebuttal testimony and exhibits will address certain revenue requirement adjustments proposed by Public Counsel witnesses which impact the Company's proposed electric and natural gas revenue requirement. Specifically, I will address certain proposed adjustments with which the Company does not agree.

Q. Which proposals of Public Counsel's witnesses impacting revenue requirements are you addressing?

A. Following is a listing of the proposals along with a brief summary of the reasons why they should be rejected:

- Customer Deposits – Mr. Dittmer's suggestion that Customer Deposits is a form of financing ignores the fact that Customers Deposits are actually a tool used by the Company to manage the write-off of uncollectable customer accounts, are short-term in nature as they are automatically returned to customers after 12 months of solid pay history, and as such should only receive a short-term interest rate; not a rate of return that combines the cost of primarily long-term debt and common equity.
- Customer Deposit Interest – Mr. Dittmer's companion adjustment to Customer Deposits should be rejected for the same reasons as the primary adjustment.
- Kettle Falls – Mr. Lott's proposal regarding treatment of the 1984 Kettle Falls disallowance should be rejected as the Company's adjustment is consistent with the treatment approved in prior cases which resolved this matter.
- Coyote Springs – Mr. Lott's proposal to project out an additional year to 2006, should be rejected in favor of using 2005 information, which eliminates additional projections of additions and retirements and produces an adjustment at a known and measurable level.
- Pro Forma Transmission - Mr. Lott's proposal to project out an additional year to 2006, should be rejected in favor of using 2005 information, which eliminates additional projections of additions and retirements and produces an adjustment at a known and measurable level.
- California Sale Overhead – Mr. Dittmer's proposal to reject the Company's updated overhead allocations due to the sale of our California jurisdiction is unsupported by fact and ignores a known and measurable change.
- American Jobs Act – Mr. Dittmer's proposal to include an estimate of the impact of the 2004 Tax Act should be rejected due to the fact that current information regarding the Internal Revenue Service's implementation of a new tax credit for wholesale electric generation activities is too uncertain for use in developing a normalized test year.
- Production Tax Credit – Mr. Dittmer's adjustment rejecting the Company's 50% sharing of a new tax credit that applies to generation from the Kettle Falls plant does not fairly reflect the Company's efforts to obtain the credit.
- Vegetation Management – Mr. Dittmer's elimination of the Company's pro forma Vegetation Management, or tree trimming, adjustment focuses on prior years' reduction to tree trimming activities as a result of financial constraints, and does not reflect the level of anticipated expenditures necessary to currently maintain our system. (The Company's Vegetation Management adjustment was accepted in the Settlement in

conjunction with a "One-Way Balance Account" that will assure authorized cost levels are expended or credited back to customers.)

II. ELECTRIC SECTION

Q. Would you please summarize the various electric revenue requirement levels that are at issue?

A. Yes. The Company's originally filed revenue requirement was $35.8 million. Public Counsel's litigation position, as contained in their August 26th filing, is $11.7 million and the multi-party Settlement revenue requirement is $22.1 million.

Q. In the Settlement Agreement, what level of rate base was agreed to by all the Signing Parties for use in the Company's revenue requirement calculation?

A. The Company's electric rate base in its initial filing was $795,845,000, and the Settlement's electric rate base level has been reduced to $792,982,000. The Settlement Agreement did not change the Company's filed natural gas rate base amount of $130,178,000.

CONTESTED ADJUSTMENTS

Q. Could you please list the various electric revenue requirement adjustments that you will be addressing that are still at issue from the Company's original filing; in doing so, please note the impact of Public Counsel's recommended adjustment to Net Operating Income ("NOI") and Rate Base as compared to the Company's original filing.

A. The table below sets forth these adjustments. Since the revenue requirement items still at issue have been recommended by Public Counsel, for convenience, I will be using the Column references that can be found in Public Counsel's summary exhibit sponsored by Mr.

Dittmer. The electric rate base adjustments and net operating income adjustments can be found on pages 2-3 and pages 12-13 of Exhibit No. ___(JRD-2), respectively.

Electric Adjustments Still at Issue (Dollars are in thousands)					
COL	**DESCRIPTION**			**PC NOI**	**PC Rate Base**
(c)	**Customer Deposits**			**$23**	**$(2,329)**
(f)	**Kettle Falls**				**$(479)**
(h)	**Coyote Springs**				**$(1,882)**
(c)	**PF Transmission Project**				**$(215)**
(c)	**Customer Deposit Interest**			**$(16)**	**-**
(d)	**CA Sale Overhead**			**$347**	**-**
(f)	**American Jobs Act of 2004**			**$235**	**-**
(g)	**Production Tax Credit (KF)**			**$992**	**-**
(h)	**Vegetation Management Exp.**			**$320**	**-**

Customer Deposits

Q. On pages 11 through 13 of Mr. Dittmer's direct testimony, Public Counsel recommends that Avista's rate base be reduced by the average balance of Customer Deposits recorded by the Company during the test year. Do you agree with Public Counsel's recommendation regarding the Customer Deposits?

A. No. Mr. Dittmer implies that Customer Deposits, which accrue interest at a short-term interest rate adjusted annually by the Washington Commission, is actually a form of financing for the Company's utility operations and should be used as a rate base reduction, effectively applying the full authorized rate of return against that balance. Generally speaking, the Company finances its utility operations through various long-term financings, both debt and equity. The suggestion that Customer Deposit balances are a financing vehicle is unsupported and unreasonable on its face. From a practicality standpoint, Washington's electric rate base in this filing is approximately $800 million. The allocated amount of Customer Deposits, as proposed by Mr. Dittmer, is only $2.3 million. As seen from this perspective, it hardly represents a rate base financing vehicle. More to the point, Customer Deposits are a tool used by the Company to help manage the costs associated with uncollectable accounts receivable. At best it is a short-term balance that should only receive a short-term interest rate, not a rate of return that combines the cost of primarily long-term debt and common equity. This is recognized by interest rates that are authorized by the Commission for application to Customer Deposits. It is a matter of established Company policy, through Commission approved rules, that Customer Deposits are automatically returned to the customer after 12 months of solid payment history. Below is the language from the Company's filed Rules Tariff 70:

> B. Deposits
>
> (1) Deposit Requirements. The Company may require a deposit under any of the following circumstances: provided, that during the winter period no deposit may be required of a customer who, in accordance with WAC 480-100-072 (4)(a), has notified the Company of inability to pay a security deposit and has satisfied the remaining requirements to qualify for a payment plan.
>
> (a) Where the applicant has failed to establish a satisfactory credit history or otherwise demonstrate that it is a satisfactory credit risk, in the manner prescribed above;
>
> (b) When, within the last 12 months an applicant's or customer's similar class of service has been disconnected for failure to pay amounts owing, to any gas or electric utility;
>
> (c) There is an unpaid, overdue balance owing to any gas or electric utility for similar class of service;
>
> (d) Three or more delinquency notices have been served upon the applicant or customer by any electric or gas company during the most recent 12 months;
>
> (e) Initiation or continuation of service to a residence where a prior customer still resides and where any balance for such service to that prior customer is past due or owing to the Company.
>
> (2) Amount of Deposit. In instance where the Company may require a deposit, the deposit shall not exceed two-twelfths of estimated annual billings.
>
> (3) Transfer of Deposit. Where a customer of whom a deposit is required transfers service to a new location within the Company's service area, the deposit, plus accrued interest less any outstanding balance from the current account, shall be transferable and applicable to the new service location.

12. ESTABLISHMENT OF CREDIT/DEPOSITS: - continued

(4) Interest on Deposits. Utilities that collect customer deposits must pay interest on those deposits calculated:

(a) For each calendar year, at the rate for the one-year Treasury Constant Maturity calculated by the U.S. Treasury, as published in the Federal Reserve's Statistical Release H. 15 on January 15 of that year. If January 15 falls on a nonbusiness day, the utility will use the rate posted on the next following business day; and

(b) From the date of deposit to the date of refund or when applied directly to the customer's account.

There is no question that Customer Deposits are a tool for management of accounts receivable write-offs, not a financing vehicle, and are very short-term in nature. They currently receive a short-term interest rate and that amount is credited to the customers who have made the deposit.

Customer Deposit Interest

Q. Mr. Dittmer proposed an adjustment to the Company's treatment of Customer Deposits on pages 11 and 12 of his testimony. In that adjustment he proposes that interest already credited to customer accounts be used as an operating expense offset to his rate base adjustment. Do you agree with this approach?

A. As I discussed earlier, Mr. Dittmer's Customer Deposit rate base adjustment should be rejected. This adjustment related to interest already credited to customer accounts is a companion adjustment (linked to his proposed rate base adjustment) and should also be rejected for the same reasons.

KETTLE FALLS – Rebuttal to Merton R. Lott of Public Counsel

Q. Do you agree with Mr. Lott's testimony pertaining to his adjustment to modify the Company's Kettle Falls disallowance adjustment?

A. No. The Company's Kettle Falls disallowance adjustment has been approved in prior cases before this Commission and should not be modified as proposed by Mr. Lott.

Q. Would you briefly provide a history of the Kettle Falls disallowance adjustment included in the Company's case?

A. Yes. The adjustment is explained in my direct testimony on page 13 beginning on line 10. This Commission disallowed a portion of the Company's investment in the Kettle Falls generating plant in Cause No. U-83-26. The Company asked that the disallowance be reconsidered in its next general rate case, Cause No. U-84-28, but the Commission reaffirmed the disallowance. The Company in December 1986 recorded a write-off for the amount of Kettle Falls investment applicable to Washington operations that was disallowed by this Commission in Cause No. U-83-26. The write-off was recorded as a charge to net income and an offset to plant in service on the balance sheet using a reserve account. The Company recorded a $5,247,725 gross write-off on its books that brought the gross investment level for Washington down to 60.02% of $80,555,706 as provided for in Cause No. U-83-26. Since the disallowance was recorded in December 1986, some three years after the plant was placed in service, there was $405,000 of accumulated depreciation associated with the gross write-off amount when the write-off was recorded.

Q. Would you please explain why the Company recorded the write-offs related to Kettle Falls?

A. Yes. In 1986 the Company elected to apply the requirements of Statement of Financial Accounting Standards No. 90 in reporting its 1986 results. Thus, the regulatory disallowance related to Kettle Falls was recorded at that time.

Q. Has the Company's Kettle Falls disallowance adjustment been approved in prior cases before this Commission?

A. Yes. In fact, Mr. Lott asked in Public Counsel Data Request PC-9 (e) that the Company "Identify and provide a copy of any WUTC Order where Mr. Faulkner's proposed treatment of this (Kettle Falls) disallowance is authorized." The Company's response to the data request is shown below:

> "Attached is the Third Supplemental Order in Docket Nos. UE-991606 and UE-991607 dated September 29, 2000. The Kettle Falls Disallowance adjustment was approved as an uncontested adjustment as shown on page 13 of the Order. Attached is the Second Supplemental Order Accepting Stipulation in Docket No. UE-900093 dated June 22, 1990. The Kettle Falls Disallowance Adjustment is shown on Appendix A to the Stipulation on page 1 in column (f). Attached is the Third Supplemental Order in Cause No. U-85-36 dated April 4, 1986. The Kettle Falls adjustment was approved as an uncontested adjustment as shown on pages16 and 31 of the Order."

In addition, the Company's Kettle Falls adjustment was not contested in Docket No. UE-011595, a case that was resolved by Settlement Stipulation. The Company's pro forma study, including the Company's Kettle Falls disallowance adjustment, was used to establish the approved general revenue requirement in that case. Also, the Company's annual commission-basis reports have consistently reflected the Kettle Falls disallowance adjustment as filed by the Company in this case.

Q. What is Mr. Lott's response to the Company's answer to Public Counsel's Data Request PC-9 (e) regarding prior Commission orders authorizing the method used by the Company for the Kettle Falls disallowance adjustment?

A. Mr. Lott simply dismisses the fact that the adjustment was uncontested in the consolidated Docket Nos. UE-991606 and UE-991607 by stating that he is "unfamiliar with the uncontested adjustment" in that case.

Mr. Lott then concludes that, since the Plant in Service disallowance in the Docket No. UE-900093 stipulation is greater than the Plant in Service disallowance used by the Company in the present proceeding, "This would imply that the schedule utilized by Mr. Falkner here could not have been used in that proceeding since the plant in service number does not change from year to year in Mr. Falkner's schedule." (page 14, lines 11-14) Mr. Lott's conclusion is not based on fact and ignores relevant information that Mr. Lott should have been aware of, as he was a member of the WUTC Staff and was directly involved in the Docket No. UE-900093 stipulation. In fact, the Staff's proformed results of operations study, as contained within prefiled Exhibit No.___(MRL-2) of Merton R. Lott, was used, with certain modifications as agreed to by the parties, to establish the revenue increase in that case.

In Docket No. UE-900093 the Company included, as separate adjustments, a Kettle Falls Disallowance Adjustment, consistent with prior Commission findings, and a Kettle Falls Precipitator Adjustment to reflect a write-off of costs associated with the first precipitator. The Kettle Falls Precipitator adjustment was included as a proforma adjustment since the write-off occurred subsequent to the end of the twelve months ended June 30, 1989 test period. Mr. Lott's Exhibit No.___(MRL-2) in that docket contained a combination of the Company's two separate adjustments into one Kettle Falls adjustment.

Attached as page 1 of Exhibit No. ___ (DMF-5) is a copy of the adjustment summary sheet of the Company showing the two separate Kettle Falls adjustments in columns (g) and (h), respectively, presented in the Company's filing in Docket No. UE-900093. As can be seen by looking at column (g), line 31, the Plant in Service disallowance amount utilized by the Company was $(5,248,000), the same figure used in the current case. The figures in writing between the two Kettle Falls adjustment columns are the amounts of the two adjustments added together. Page 2 of Exhibit No. ___ (DMF-5) is a copy of the page from Appendix A to the Stipulation in Docket No. UE-900093. Column (f), line 27 shows the combined Plant in Service amounts of $(5,483,000) from the two Kettle Falls adjustments that were combined by the Staff. The combined amount of $(5,483,000) used in Mr. Lott's exhibit consists of the $(5,248,000) disallowance amount consistent with prior Commission orders and $(235,000) associated with the precipitator write-off. Hence, Mr. Lott's contention that the disallowance amount used in the current proceeding of $(5,248,000) is different from the disallowance amount used in Docket No. UE-900093 is not correct.

Q. Do you have further comments related to Mr. Lott's testimony regarding the Stipulation in Docket No. UE-900093?

A. Yes. At page 14, line 9 of Mr. Lott's testimony he states that the issue (Kettle Falls disallowance) is not discussed in the UE-900093 stipulation. This is simply not true. In fact, page 6 of the stipulation states:

> "B. Levels of Allowed Kettle Falls Investment.
> All issues pertaining to the Commission allowed amount of Kettle Falls gross investment for ratemaking purposes shall be deferred to a later proceeding. (See, e.g. prefiled testimony of Staff witness Nguyen at pages 2-6.)"

As I just discussed, this was later included in two future proceedings. The adjustment has never been contested and the issue has been resolved. Mr. Lott's suggestions otherwise are unsupported.

Q. Would you please address Mr. Lott's contention that the 60.02% allocation factor is not appropriate for calculating the Kettle Falls disallowance?

A. Yes. Mr. Lott makes this contention at the top of page 13 of his direct testimony. The 60.02% allocation factor was the Washington allocation factor in Cause No. U-83-26 when the Commission disallowed a portion of Kettle Falls investment. The Company recorded a write-off under the provisions of the Statement of Financial Accounting Standards No. 90 using the 60.02% allocation factor. Mr. Lott's position is that the Commission's ordered disallowance in Cause No. U-83-26 should change from year to year depending on how the production/transmission allocation factor changes from year to year rather than being a fixed, one-time write-off amount. The result would be additional write-offs or, conversely, write-ups being recorded every year. This would be an unacceptable outcome and his proposal should be rejected; otherwise there would never be certainty around a final resolution of this matter for financial reporting purposes.

Q. What is the Company's response to Mr. Lott's testimony regarding the Company's use of accumulated depreciation amounts associated with the Kettle Falls disallowance from the rate year of 2006 rather than the test year of 2004?

A. The Company has agreed in the Settlement Agreement to modify the adjustment back to the test year of 2004 rather than use accumulated depreciation figures from the rate year of 2006 as the Company originally proposed.

Q. Why did the Company propose using accumulated depreciation amounts from the rate year of 2006?

A. In Docket Nos. UE-991606 and UG-991607 Michael P. Parvinen, a witness for the WUTC Staff, proposed modifications to the Company's Weatherization and DSM Investment adjustment and to the Company's Settlement Exchange Power adjustment. Mr. Parvinen proposed that rate year levels be reflected for these adjustments as opposed to test period levels that were proposed by the Company. Mr. Parvinen recognized that his proposed rate period treatment was different than in past rate cases, but argued that the rate period modifications should be adopted since these adjustments are not subject to additional investment or change other than amortization. The WUTC adopted Mr. Parvinen's rate period modifications.

In the current case the Company consistently applied the rate period precedent from Docket Nos. UE-991606 and UG-991607 to the Weatherization and DSM Investment (gas only), Settlement Exchange Power, Deferred Gain on Office Building, Colstrip 3 AFUDC Elimination, Colstrip Common AFUDC, Kettle Falls Disallowance, and PGE Monetization adjustments.

Q. Would you please summarize your rebuttal to Mr. Lott regarding the Kettle Falls disallowance issue?

A. Yes. The Company's Kettle Falls disallowance adjustment has been approved in prior cases before this Commission and should not be modified as proposed by Mr. Lott. For purposes of the Settlement Agreement the Company has agreed to modify the accumulated depreciation amounts back to the test year of 2004 rather than use accumulated depreciation figures from the rate year of 2006 as the Company originally proposed.

Coyote Springs

Q. On pages 20 through 21 of Mr. Lott's direct testimony, Public Counsel recommends that Avista's rate base associated with the incremental costs of Coyote Springs 2 be reduced by the additional projected passage of time between 2005 and 2006. Do you agree with Public Counsel's recommendation?

A. No. Mr. Lott generically discussed what he characterizes as the "Matching Principle" from pages 14 to page 18 of his direct testimony. Mr. Lott also discusses Avista's acquisition of the second half of the Coyote Springs 2 Project ("CS2") and concludes on page 20 of his testimony, "I do not raise a prudence issue with regard to this purchase." No party has raised any prudence issues associated with acquisition of the second half of CS2. As has been detailed in other Company testimony, I will also note that the acquisition of this additional resource has been properly included in the AURORA model as a generating resource in the preparation of the Company's pro forma power supply costs. Thus, what we are left with is the introduction of the incremental capital and associated O&M costs of having the second half of CS2 as a resource.

Q. Please explain the details behind the Company's CS2 adjustment and why Public Counsel's adjustment should be rejected.

A. Avista became the owner of the second half of CS2 in January 2005. Since that time, the second half of CS2 has been an operational generating asset of Avista and has been economically dispatched to cover retail customer load or used to produce incremental benefits to the Company's power supply portfolio. Any power supply benefits associated with the economic dispatch of CS2 have been captured by the ERM deferral mechanism.

With this in mind, our original pro forma adjustment simply brought in the capital and associated O&M costs with the most recent known and measurable information available to the Company—that being 2005 capital and O&M information. There are no mismatches. The benefits of dispatching the second half of CS2 have been captured in the power supply model, using 2004 loads, and the capital and O&M costs have been included on a basis that is most consistent with the cost of the first half of CS2, calendar year 2005. What this does is eliminate the need to try to predict, or project 2 years out, what incremental additions and retirements are going to be incurred for CS2 during 2005 and 2006, and produces a known and measurable result.

The suggestion by Mr. Lott that the Company's adjustment somehow violates some unspecified sections of the Internal Revenue Code ("IRC") is a "red herring." It is the Company's responsibility to maintain its financial books and records in accordance with both generally accepted accounting principles and federal and state tax rules, and as such, we have determined that the Coyote Springs adjustment is appropriate for inclusion in our authorized revenue requirement.

Q. A Production Factor Adjustment is addressed by other Company witnesses, however, as it relates to historical rate base and CS2, would you please comment on Mr. Lott's testimony on pages 17 and 68 of his direct testimony regarding net production rate base?

A. Yes. Mr. Lott makes unsubstantiated claims regarding a steady trend downward in net production plant (production plant in service less related accumulated depreciation and deferred taxes). In fact, net production plant in service allocable to Washington electric operations in 2004 is greater than net production plant in service in 2002 by over $50 million. The Company's figures come from the Commission basis report for 2002 and the Company's filing in this docket for 2004 and do not include the second half of Coyote Springs 2.

Additionally, most all components of Company rate base are anticipated to grow. Below is a portion of the testimony that Mr. Malquist, the Company's Chief Financial Officer, submitted in its direct filing:

> "The amount of capital expenditures planned for 2005-2006 is approximately $275 million. For 2005 alone, these costs equate to a total of $145 million. A few of the major capital expenditure items include $58 million for transmission and distribution upgrades, $33 million for electric and natural gas customer growth, $11 million for environmental affairs (associated with the Spokane River relicensing and the 2001 Clark Fork River license implementation issues), and $12 million for generation upgrades."

Regardless of the direction Company rate base has moved historically, or is projected to move prospectively, the Company's rate base in this general filing is the result of Commission accepted methodologies for test year levels and known and measurable changes associated with new generation capacity and needed transmission capabilities.

<u>**Pro Forma Transmission Project**</u>

Q. On pages 21 and 22 of Mr. Lott's direct testimony, Public Counsel again recommends that Avista's rate base be reduced by the additional projected passage of time between 2005 and 2006. Do you agree with Public Counsel's recommendation regarding the pro forma transmission projects?

A. No. The majority of the rationale for rejection of the Public Counsel's adjustment for the second half of CS2 also applies to their proposal to the Pro Forma Transmission Project. There is no mismatch associated with inclusion of these projects. They are being included because of their close timing with the historical test year and the materiality of the ongoing transmission upgrades. Also, 2005 is utilized for the calculation because that is the year of completion of the projects and its use eliminates the need for additional speculation associated with projecting capital additions and retirements through 2006. Here again there are no issues with federal tax rules due to the Company's adjustment that would impact a decision by this Commission.

California Sale Overhead

Q. On pages 14 through 17 of Mr. Dittmer's direct testimony, Public Counsel proposes that the Company's adjustment to allocated costs associated with the sale of Avista's California gas operations is not appropriate and should not be accepted. Do you agree with Public Counsel's contentions regarding the Overhead Cost Adjustment?

A. No. The Company began operating its Oregon and California natural gas properties in 1991. The Company did not add any utility employees as a result of this transaction that would be considered corporate or overhead. Moreover, a number of positions of the previous operator, CP National, were eliminated. A new common cost allocation methodology known as the 4-Factor was introduced, reviewed by regulatory Staff of "all" four jurisdictions and accepted. As a result, Avista common costs, which had not increased due to the acquisition of the Oregon and California properties, began being allocated to a much larger customer base and over four jurisdictions, versus the original Washington and Idaho jurisdictions. The Company's adjustment in this case merely reflects the sale of the California properties and follows the accepted common cost allocation methodology and takes into account a known and measurable change to our customer base.

Q. Is Mr. Dittmer's proposal supported by any tangible fact or information not taken into account by the Company?

A. No. The Company has stated that the decision to sell its California properties was a strategic decision based on its goal of focusing on its core utility operations in the Northwest. As noted earlier, the Company did not add overhead employees as part of the California acquisition; in fact, direct employees were reduced from the acquired operations, and no employees have been eliminated from the Company's corporate offices to produce common overhead reductions.

Q. Please address Mr. Dittmer's second contention regarding a "credit" for previous savings.

A. Mr. Dittmer attempts to make a case that somehow "the benefits from savings resulting from such economies of scale" be instantly reflected in customers' rates. As noted in Mr. Dittmer's testimony, it is true that there was a period of time from the acquisition of the California properties to when general gas and electric rates were increased by a general rate case in 1997 and 1999, respectively, that overhead allocations had been reduced for our Washington jurisdiction. However, customers also did not have their rates increased during that time period and a case could be made that the reduced overhead cost allocations contributed to the Company's ability to defer or delay general rate changes, thus directly benefiting customers.

Furthermore, it is understood that in-between rate cases there are changes in revenues and expenses, in both directions, that cause the Company to either under-recover or over-recover its costs. It would be inappropriate to "cherry pick" certain categories of costs over an extended period of time and without considering changes in other costs categories.

Q. Please summarize your response to Public Counsel's proposal to reverse the Company's California Overhead adjustment.

A. The proposal is unsupported by fact and would require ignoring a known and measurable change. For the reasons stated above, it should be rejected and the Company's original calculation should be accepted.

<u>American Jobs Act of 2004</u>

Q. On pages 19 through 22 of Mr. Dittmer's direct testimony, Public Counsel recommends that anticipated savings from the American's Job Creation "Tax" Act of 2004 be incorporated into Avista's revenue requirement calculation in this case. Do you agree with Public Counsel's recommendation regarding the savings from the 2004 tax act?

A. No. We believe the introduction of this tax deduction into general rates should be reviewed and incorporated in a future proceeding when the Internal Revenue Service treatment is more measurable. In regards to the specific adjustment, Mr. Dittmer is focusing on a section of the 2004 Act that introduces a tax "deduction" for domestic production activities of electric utilities. What is at issue here is the level of uncertainty associated with the implementation of this new tax calculation. Mr. Dittmer appropriately discusses this in some detail. Additionally, the Company provided information to the Commission in February of this year as part of an investigation, Docket No. 042243, regarding the level of uncertainty and the timing associated with when Internal Revenue Service policy and treatment of this deduction will become known. Below is a portion of our response:

> "The Act created a new deduction for qualified domestic production activities of U.S. businesses under Section 199 of the Internal Revenue Code (IRS). Electrical energy production is included in the definition of qualified production activities. Based on the information currently available, Avista believes that it may receive a tax benefit from the

> generation and sale of electricity under provisions of Section 199 beginning in 2005. The amount of such tax benefit is extremely difficult to accurately estimate at the present time. The difficulty arises from the fact there is minimal guidance presently available from the IRS for how a vertically integrated utility would make the appropriate calculations.
>
> The law requires that indirect costs such as interest and administrative costs be allocated to the production activity. As a result we are faced with developing both cost allocations and pricing assumptions, each of which will have a material impact on the eventual deduction that may be available beginning with the 2005 tax year. In addition there are other limits with respect to overall taxable income that could materially impact the actual tax benefit available. Our best current estimate of the annual tax benefit is approximately $750,000 on a system basis, but the actual benefit could be substantially different from this amount. Washington's current jurisdictional share of that amount would be approximately $490,000.
>
> Based on the information currently available from the IRS, the Company doesn't believe that its natural gas operations will qualify for any new tax deductions as a result of the Act. The Act does not impact the Company's 2004 Federal tax return. The Company's 2005 Federal tax return will not be filed until approximately September 15, 2006, and then will be subject to audit and review by the IRS in 2007 or 2008."

As noted, our first tax return to include this new tax deduction will not even be made until one year from now.

Q. Does Mr. Dittmer's approach to the 2004 Act deduction differ from his recommendation regarding the California Sale Overhead adjustment?

A. Yes. In Mr. Dittmer's overhead adjustment, his argument against re-allocating "any" corporate overheads due to the elimination of the California operations was the need for 100% certainty that cost savings won't be produced that might partially offset the overhead re-allocation. Yet, in regards to the tax adjustment he states at page 20, lines 12 through 15, that,

> "To totally ignore such known legislation, and include no estimate of its impact, would result in a greater injustice than attempting to include some estimate of its impact at this point in time."

Clearly, his concern over accuracy of the calculation of adjustments is not consistently applied in these two cases, and appears to be dictated by the direction of the adjustments' impact on net operating income.

Q. Was this tax deduction from the American Jobs Creation Act addressed in the multi-party Settlement filed with this Commission?

A. Yes. For purposes of settlement, an estimate of the benefit from the domestic production tax deduction was incorporated as a reduction in the overall electric revenue requirement.

<u>**Production Tax Credit (KF)**</u>

Q. On pages 22 through 25 of Mr. Dittmer's direct testimony, Public Counsel recommends that 100% of the "bio-mass" production tax credit associated with operation of the Kettle Falls plant be used to reduce the electric revenue requirement, versus the 50% level proposed by the Company. Do you agree with this ratemaking treatment?

A. No. The primary reason for a sharing of the production tax credit between the Company and customers is that the Company was actively involved in getting the tax credit included in the 2004 Tax Act through lobbying efforts that have been excluded for recovery for ratemaking purposes.

Q. Does the Company have an alternative approach it would be willing to recommend versus the 50% level proposed in its direct case?

A. Yes. The recoverability of the Company's investment in the Kettle Falls generating station was set at 90%/10% between customers and the Company by a 1984 Order of the Washington Commission. A 90%/10% sharing of the new production tax credit would, at a minimum, synchronize the tax credit recoverability with the rate base treatment afforded the plant, it would recognize the Company's lobbying efforts to obtain the credit from Congress and could serve as an incentive for continued effective lobbying efforts aimed at keeping the cost of operations as low as possible for our customers.

Q. Was this Kettle Falls Production Tax Credit taken into account in the multi-party Settlement filed with this Commission?

A. Yes. For purposes of settlement, 100% of the Production Tax Credit is serving as a reduction to the electric revenue requirement. The Company proposes that, as the Production Tax Credit is a variable amount directly tied to the generational output of the Kettle Falls plant, the difference between the level that is approved in this case and the actual credits received in future periods should be tracked through the ERM mechanism.

Vegetation Management Expense

Q. On pages 26 through 32 of Mr. Dittmer's direct testimony, Public Counsel recommends that Avista's Pro Forma Vegetation Management adjustment should be reversed. Do you agree with Public Counsel's recommendation regarding Vegetation Management?

A. No. The Company's pro forma Vegetation Management, or tree trimming, adjustment is aimed at matching the rate recovery of tree trimming with the Company's increased commitment to maintenance of its distribution system. The Company's financial situation in recent years has impacted the level of resources available for operations, including tree trimming, starting back in 2000. Focusing on system level distribution line maintenance charged to FERC account 593, which our adjustment is primarily directed at, an average of the 4 years preceding 2000 ('96-'99), for distribution tree trimming costs was almost $3 million. Since that time, the average annual distribution tree trimming costs has been $1.9 million. The test year 2004 level is

$2.3 million, basically 75% of the '96-'99 average. This doesn't even take into account any escalation in costs for the last 5 years. The Company is committed to addressing deferred circuit tree trimming maintenance, as well as maintaining the regular planned circuit work. Since the lowest level in 2002, the Company has increased its expenditures from the 2002 level of $988,000 to $1,524,000 in 2003 to $2,280,000 in 2004. The 2005 budget for account 593, tree trimming contract crew work, is $3.7 million, $1.4 million above the 2004 actual level of expenditures.

Q. If the Settlement is approved, do Avista customers have assurance that the dollars approved in rates for Vegetation Management will be dedicated to those activities?

A. Yes they do. The Agreement reached by Avista and the Settling parties includes a One-Way Balancing Account to track funds dedicated to and spent on vegetation management activities. In the event dollars for vegetation management are not spent in a given year, that unspent balance will be accounted for and spent in the subsequent year(s) or credited back to customers. This element of the Agreement gives the Company some flexibility in meeting often-competing financial objectives on a yearly basis, while at the same time providing customers the certainty that funds collected in rates on a proforma basis will be dedicated to Avista's vegetation management program.

III. NATURAL GAS SECTION

Q. Before beginning your discussion of contested adjustments, what is your response to Public Counsel's Interest Synchronization Adjustment?

A. The only difference between the Company's Pro Forma Debt Interest, or Interest Synchronization adjustment, and Public Counsel's, is the level of authorized rate base, both electric and natural gas, and the weighted cost of debt that is used in the calculation. At this point in time Public Counsel is using different rate base and debt cost figures, but the methodology they are employing is exactly the same as originally filed by the Company. Once a final determination has been made by the Commission related to authorized rate base and cost of capital, the final Interest Synchronization adjustment can be calculated. At that point, it is simply a matter of mechanics.

CONTESTED ADJUSTMENTS

Q. Would you please list the various natural gas revenue requirement adjustments that you will be addressing that are still at issue from the Company's original filing; in doing so, please note the impact of Public Counsel's recommended adjustment to Net Operating Income ("NOI") and Rate Base as compared to the Company's original filing.

A. Certainly. Please see the table below. Since the revenue requirement items still at issue have been recommended by Public Counsel, for convenience, I will again be using the Column references that can be found in Public Counsel's summary exhibit sponsored by Mr. Dittmer. The natural gas rate base adjustments and net operating income adjustments can be found on page 2 and page 4 of Exhibit No. ___(JRD-3), respectively.

Natural Gas Adjustments Still at Issue
(Dollars are in thousands)

COL	DESCRIPTION			PC NOI	PC Rate Base
(c)	**Customer Deposits**				**$(1,050)**
(c)	**Customer Deposit Interest**			**$(7)**	-
(d)	**CA Sale Overhead**			**$103**	-

Q. In regards to these contested adjustments, as they are identical to certain contested electric adjustments, is Public Counsel's methodology and theory consistently applied between the Company's electric and natural gas revenue requirement calculations?

A. Yes.

Q. With that in mind, is the Company's position and supporting arguments the same as outlined in your previous Electric Section?

A. Yes they are.

Q. Does this conclude your rebuttal testimony?

A. Yes it does.

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NOS. UE-050482 /UG050483

EXHIBIT NO. ______ (DMF-5)

DON M. FALKNER

REPRESENTING AVISTA CORPORATION

THE WASHINGTON WATER POWER COMPANY
ELECTRIC RESULTS OF OPERATION
ADJUSTMENT SUMMARY
TWELVE MONTHS ENDED JUNE 30, 1989
(000'S OF DOLLARS)

Line No.	DESCRIPTION	Settlement Exchange Power f	Kettle Falls Disallowance g	Kettle Falls Precipitator h	Weath. and Conserv. i	Revenue Norm. j
	REVENUES					
1	Total General Business					-$414
2	Interdepartmental Sales					
3	Sales For Resale					
4	Total Sales of Electricity	0	0	0	0	-414
5	Other Revenue					
6	Total Electric Revenue	0	0	0	0	-414
	EXPENSES					
	Production and Transmission					
7	Operating Expenses					
8	Purchased Power					
9	Depreciation and Amortization	-1,836	-164 (171)	-7		
10	Taxes					
11	Total Production & Transmission	-1,836	-164 (171)	-7	0	0
	Distribution					
12	Operating Expenses					
13	Depreciation					
14	Taxes					-16
15	Total Distribution	0	0	0	0	-16
16	Customer Accounting					-2
17	Customer Service & Information				-186	
18	Marketing					
	Administrative & General					
19	Operating Expenses					-1
20	Depreciation					
21	Taxes					
22	Total Admin. & General	0	0	0	0	-1
23	Total Electric Expenses	-1,836	-164 (171)	-7	-186	-19
24	OPERATING INCOME BEFORE FIT	1,836	164 171	7	186	-395
	FEDERAL INCOME TAX					
25	Current Accrual		110	5	63	-134
26	Deferred Income Taxes	444	-62 } 50	-3		
27	Amortized Investment Tax Credit					
28	SETTLEMENT EXCHANGE POWER	8,466				
29	NET OPERATING INCOME	-$7,074	$116 121	$5	$123	-$261
	RATE BASE					
	PLANT IN SERVICE					
30	Intangible					
31	Production		-5,248 (5,483)	-235	12,384	
32	Transmission					
33	Distribution					
34	General					
35	Total Plant in Service	0	-5,248 (5,483)	-235	12,384	0
36	ACCUMULATED DEPRECIATION		-733 (35)	698		
37	ACCUM. PROVISION FOR AMORTIZATION					
38	Total Accum. Depreciation & Amort.	0	-733 (35)	698	0	0
39	GAIN ON SALE OF BUILDING					
40	DEFERRED TAXES		711 (738)	27		
41	TOTAL RATE BASE	$0	-$3,804 (4,710)	$906	$12,384	$0
42	RATE OF RETURN					

The Washington Water Power Company
Electric Results of Operation
Twelve Months Ended June 30, 1989
Cause No. UE-90-0093
(thousands of dollars)

Appendix A

Page 1 of 5

Line No.	Description	Actual a	Deferred FIT b	Gain on Office Bldg. Sale c	Colstrip 3 AFUDC Eliminations d	Colstrip Common AFUDC e	Kettle Falls Per U-83-26 f	Weatherization and Conservation g
	Revenues:							
1	Total General Business	205,354						
2	Interdepartmental Sales	669						
3	Sales for Resale	44,397						
4	Other Revenue	5,859						
5	Total Electric Revenue	256,279	0	0	0	0	0	0
	Expenses:							
	Production & Transmission:							
6	Operating	43,031						
7	Purchased Power	37,882						
8	Depreciation & Amortization	16,616						
9	Taxes	8,587			(224)	59	(171)	
10	Total Production & Transmission	106,116	0	0	(224)	59	(171)	0
	Distribution:							
11	Operating	6,935						
12	Depreciation	6,392						
13	Taxes	18,171						
14	Total Distribution	31,498	0	0	0	0	0	0
15	Customer Accounting	6,955						
16	Customer Service & Information	3,092						
17	Marketing	663						
	Administrative & General:							
18	Operating	13,924						
19	Depreciation	1,717						
20	Taxes	242						
21	Total Administrative & General	15,883	0	0	0	0	0	0
22	Federal Income Taxes	24,225					50	
23	Total Operating Expenses	188,432	0	0	(224)	59	(121)	0
24	Net Operating Income	67,847	0	0	224	(59)	121	0
25	Settlement Exchange	0						
26	Adjusted Net Operating Income	67,847	0	0	224	(59)	121	0
	Rate Base:							
27	Plant in Service	783,684			(7,115)	595	(5,483)	
28	Conservation Investment Loss	0						11,806
29	Accumulated Depr. & Amort.	159,632			(1,118)		(35)	
30	Other Deferred Credits(Debits)	0		3,076				
31	Deferred Taxes	0	52,310	(1,345)			(738)	
32	Net Rate Base	624,052	(52,310)	(1,731)	(5,997)	595	(4,710)	11,806
33	Rate of Return	10.87%						

Exhibit No. ___(DMF-5)