BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET No. UE-050482

REBUTTAL TESTIMONY OF

WILLIAM G. JOHNSON

REPRESENTING AVISTA CORPORATION

1 **I. INTRODUCTION**

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

3 **Corporation.**

4 A. My name is William G. Johnson. My business address is 1411 East Mission

5 Avenue, Spokane, Washington, and I am employed by the Company as a Senior Power Supply

6 Analyst in the Energy Resources Department.

7 **Q.** **Have you provided direct testimony in this filing?**

8 A. Yes I have.

9 **Q.** **What is the purpose of your rebuttal testimony?**

10 A. The purpose of my rebuttal testimony is to address adjustments by Mr. Lott and

11 Mr. Falkenberg regarding certain power supply expenses. These adjustments are summarized in

12 Mr. Lott's Exhibit No. (MRL-3) columns G and H, and in Mr. Falkenberg's Table 1 on page 4 of

13 Exhibit (RJF-1CT) under section II, Other Power Supply Cost Issues.

14 **Q.** **Which recommendations of Mr. Lott and Mr. Falkenberg's for power supply**

15 **adjustment are you addressing?**

16 A. The Company's response with respect to each of Mr. Lott's adjustments are

17 briefly summarized below:

18 1. CS2 Gas Transportation Expense Adjustment:
19 • Mr. Lott's adjustment results in a 2006 expense less than current 2005
20 expense.
21
22 2. Kettle Falls Fuel Cost Adjustment:
23 • Mr. Lott's adjustment is not reasonable because it is based on a fuel cost less
24 than current 2005 costs and contracted 2006 costs are known to be higher.
25
26
27

1   3.   <u>Short-term Wheeling Expense:</u>

2   •   Mr. Lott's analysis is based on modeled short-term sales and purchases that

3   would underestimate the amount of actual short-term purchases and sales and

4   significantly understates actual expenses.

5

6   4.   <u>Broker Fees:</u>

7   •   Mr. Lott's analysis is based on the same understatement of short-term sales

8   and purchases as contained in his short-term wheeling adjustment. Historic

9   averages support the Company's proforma.

10

11   5.   <u>Wanapum Expense:</u>

12   •   The adjustment to arbitrarily exclude O&M cost increases is not supported

13   and results in a 2006 expense lower than current 2005 expense.

14

15   6.   <u>Garrison-Burke Wheeling Expense:</u>

16   •   The adjustment, which is based on excluding 2 years from a 5-year average,

17   has no reasonable basis.

18

19   7.   <u>Rathdrum Lease Expense:</u>

20   •   The Company is terminating the Rathdrum lease. The revenue requirement of

21   a rate-based Rathdrum plant, although lower in the long-term, will be higher

22   than the lease expense included in proforma. Therefore, the Company's

23   existing request in this case is already lower than the known and measurable

24   costs going forward.

25

26   8.   <u>Production Property Adjustment:</u>

27   •   The retail revenue credit in the ERM is a production factor adjustment and

28   prevents the Company from over-recovery of the cost of production plant.

29

30 The Company's position with respect to each of Mr. Falkenberg's adjustments are briefly

31 summarized below:

32   1.   <u>Short-term Wheeling Expense Adjustment:</u>

33   •   Mr. Falkenberg's adjustment, which is based on a four-year average, contains

34   a math error. As corrected, his adjustment is much less than stated in his

35   testimony.

36

37   2.   <u>Kaiser DES Revenue Adjustment:</u>

38   •   Mr. Falkenberg's adjustment is based on a misunderstanding of what is

39   included in 2004 test-year revenue. Test-year revenue included the sale of

1   deviation energy that was not included in the Company's proforma because it
2   nets to no net revenue after expenses are included.
3

4   **Coyote Springs 2 Gas Transportation**

5   **Q.   What is the Coyote Springs 2 gas transportation expense?**

6   A.   This is the fixed gas transportation charge Avista pays to transport gas from

7   AECO in Canada to Coyote Springs 2. It consists of charges on three legs of transportation, two

8   legs in Canada and one leg in the United States. The Canadian legs are priced in Canadian

9   dollars so the cost fluctuates based on the Canadian exchange rate.

10   **Q.   Is this the Coyote Springs 2 gas transportation cost that was removed in the**

11 **Settlement?**

12   A.   No. The Settlement priced Coyote Spring 2 gas at an AECO price instead of a

13 Malin price. This removed any potential double counting of gas transportation costs because the

14 Company purchases firm transportation from AECO to the Coyote Spring 2 plant. The costs that

15 are the subject of Mr. Lott's recommended adjustment are the actual contractual costs the

16 Company incurs to purchase firm gas transportation from AECO to Coyote Springs 2. Mr. Lott

17 recommends that the proforma expense for these costs be reduced by $240,000.

18   **Q.   Do you concur with Mr. Lott's proposed adjustment to the Coyote Springs 2**

19 **gas transportation expense?**

20   A.   No.   Mr. Lott's proposed adjustment produces an annual expense in the 2006

21 proforma year that is <u>lower than</u> the expense we are currently experiencing in 2005. Mr. Lott's

22 recommended adjustment to reduce proforma expense by $240,000 results in a 2006 proforma

23 expense of $6 million. The Company's proforma included expense of $6.240 million. Based on

1 actual 2005 billings the expense level is currently at approximately $6.148 million. There is no

2 basis to assume that these costs will be decreasing.

3   Part of the reason Mr. Lott's expense is too low is the Canadian exchange rate. Mr.

4 Lott's analysis used an exchange rate of 79.35 US cents/Canadian dollar while the average rate

5 this year through July has been 81.18 US cents/Canadian dollar. As stated earlier, two of the

6 three legs of gas transportation are priced in Canadian dollars and fluctuate with the Canadian

7 exchange rate. Mr. Lott's adjustment results in proforma expenses less than current 2005

8 expenses and should be rejected.

9 **Kettle Falls Fuel Cost**

10   **Q.   Can you explain why Mr. Lott recommends a positive adjustment to the**

11 **proforma for Kettle Falls fuel expense?**

12   A.   Yes. In developing the proforma cost of Kettle Falls fuel in the Aurora model, the

13 cost of fuel for Kettle Falls was understated. The Company made an adjustment for this error in

14 the Settlement. Mr. Lott also recognized that the proforma understated the Kettle Falls fuel cost

15 and proposed his own positive adjustment.

16   **Q.   Do you concur with Mr. Lott's proposed Kettle Falls fuel cost adjustment?**

17   A.   I agree with the direction but not the magnitude. Mr. Lott has proposed an

18 adjustment that results in 2006 proforma costs that would be lower than what the Company is

19 actually experiencing in 2005, and would almost certainly be much lower than 2006 expenses,

20 given the upward trajectory of fuel costs. This is primarily a result of using a unit fuel cost that

21 is too low.   Mr. Lott proposes a unit fuel cost of $17.085/ton. The actual 2005 costs through

22 August have been $17.84/ton. The Company projects unit fuel costs to be $19.18/ton in 2006.

23   **Q.   Why are fuel costs at Kettle Falls increasing?**

1   A.   The primary reason is the cost of other fuels in general. First, roughly half of the

2   Kettle Falls fuel cost is transportation. The trucking firms delivering the fuel have diesel cost

3   escalation factors built into their contracts. As the cost of diesel increases, so does the cost of

4   transporting the fuel, driving up the final delivered cost. Second, one of the large fuel suppliers

5   has a contract that ties the price Avista pays to the price of natural gas. This was done because

6   the supplier was using gas for their drying kilns and they had an option to switch over to burning

7   their own hog fuel instead of using natural gas. In order to keep this large supply of hog fuel

8   available for Kettle Falls, a contract was developed that ties the price Avista pays for this fuel to

9   the price of natural gas. The increase in the price of natural gas has driven up the fuel price from

10 this large supplier. Finally, the overall increase in all fuel costs is putting upward pressure on the

11 price of hog fuel because of the ability, in some instances, to substitute hog fuel for other fuels.

12   In the current market, however, the fuel cost at Kettle Falls is still attractive. The

13 expected fuel cost in 2006 expressed in dollar per megawatt-hour is $27.81/MWh. This

14 compares favorably with purchasing electric power at market rates or generating with any other

15 resources other than hydroelectric or coal fired plants.

16   **Q.   What is the appropriate adjustment to Kettle Falls fuel costs?**

17   A.   Mr. Lott's proposed adjustment increases Kettle Falls fuel cost by $727,000

18 (system) above that included in the Company's original filing. Based on the latest fuel cost

19 estimates, the adjustment to Kettle Falls fuel expense should be an increase of $1,788,000

20 (system) above the amount shown on Exhibit No. ___(WGJ-2). The comparable adjustment

21 included in the Settlement is an increase of $1,164,000 (system), $793,000 (Washington).

22 **Short-term Wheeling Expense**

23   **Q.   What does the short-term wheeling expense represent?**

1   A.   The short-term wheeling expense is a cost Avista incurs to purchase additional

2   transmission above the amount of its long-term firm transmission. It is typically purchased to

3   move power to or from the Mid Columbia that is in excess of the Company's firm transmission

4   rights between the Mid Columbia and Avista's system.

5   **Q.   Do you concur with Mr. Lott's proposed adjustment to the short-term**

6   **wheeling expense?**

7   A.   No. Mr. Lott's proposed adjustment is based on an incorrect analysis that

8   significantly understates the short-term wheeling expense. His analysis results in a proforma

9   expense that is significantly lower than <u>any</u> of the previous five years and $294,000 less than the

10   average of the past five years. In the 2004 test year, short-term wheeling expenses totaled

11    $248,000. Mr. Lott proposes that this be reduced to only $54,000.

12   Mr. Lott's analysis deriving his $54,000 proposed proforma expense contains two major

13   errors. His first error is to mix total system sales and purchases with short-term sales and

14   purchases. He does this by dividing short-term wheeling expense by <u>total system sales and</u>

15   <u>purchase volumes</u> (MWh) to derive wheeling expense per unit of total sales and purchases. He

16   then adjusts this wheeling expense per unit of total sales value by the BPA transmission rate

17   increase and multiplies it by the proforma <u>short-term purchases and sales volume</u>s as determined

18   by the Aurora model. Short-term purchase and sales volume is only approximately one-half of

19   total purchase and sales volume. Therefore, the error of first dividing by total volumes and then

20   multiplying by only short-term volumes approximately cuts in half the proforma wheeling

21   expense.

22   Mr. Lott's second error is not recognizing that actual short-term purchase and sales

23   volumes always exceed modeled short-term purchase and sales volumes. Comparing modeled

1   short-term purchases and sales volumes from Commission Basis Reports to actual short-term

2   purchase and sales volumes for the years 2000 through 2004 reveals that modeled volumes are

3   only 21 percent of actual volumes. Even if the year 2000 is excluded, due to a high volume of

4   transactions, the four-year average ratio of modeled to actual short-term volumes is still only 37

5   percent. Not recognizing that modeled energy volume is only one-fifth to one-third of the actual

6   volumes further understates proforma short-term wheeling expense by a factor of three to five.

7   **Q.   Why is the actual volume of short-term transactions higher than the modeled**

8   **volumes?**

9   A.   Models, such as Aurora, are assumed to have perfect liquidity and perfect

10   foresight. They buy or sell exactly the right number of megawatts each hour in order to balance

11   the system. In reality, this isn't possible. Power markets are not perfectly liquid in each hour.

12   What happens is that standard blocks, such as on-peak or off-peak, are bought and/or sold in the

13   term or prescheduled market and then real time operators balance the system with additional

14   purchases and sales in the daily or hourly markets.   This results in more short-term purchase and

15   sales volumes than what would occur if we could always wait until the hour and then buy or sell

16   only what was required.

17   Models also have perfect foresight. For example, the Aurora model knows in January of

18   any given year what the hydro generation will be for the balance of the year. The model doesn't

19   purchase or sell power based on expected conditions as happens in actual operations. Later those

20   purchases or sales may have to be reversed when hydro generation turns out different than

21   expected. This creates additional short-term purchase and sales volumes.

1   In summary, <u>actual operations</u> of a system require much <u>greater volumes</u> of short-term

2   purchases and sales than are represented by models, such as Aurora, that has both perfect

3   foresight and liquidity.

4   **Q.   What does all this mean in regards to Mr. Lott's recommended adjustment**

5   **to short-term wheeling expense?**

6   A.   It means that Mr. Lott's recommendation on the short-term wheeling is based on

7   incorrect assumptions and should be rejected. His analysis contains two major errors that

8   produce a resulting proforma expense that is not credible. In fact, if his errors are corrected it

9   results in an even higher wheeling expense than what is included in the Company's original

10   filing.

11   **Q.   You recommend that Mr. Lott's adjustment to short-term wheeling expense**

12   **be rejected. Do you have any comments on Mr. Falkenberg's proposed adjustment that**

13   **drops the year 2000 and instead is based on a four-year average?**

14   A.   Yes I do. I can't totally disagree with Mr. Falkenberg that the year 2000 short-

15   term wheeling expenses appear high compared to the years since then. In that regard, a four-year

16   average may not be unreasonable. However, I can't agree with his adjustment. I don't agree that

17   his adjustment is actually based on a four-year average. Based on my workpaper P87, the 4-year

18   average expense (2001 – 2004) is $226,000. The proforma expense is $348,000, which should

19   result in Mr. Falkenberg's adjustment being (-$122,000), not (-$200,000) as stated in his

20   testimony. In conversations with Mr. Falkenberg, he apparently agrees that his adjustment

21   should have only been (-$122,000), not (-$200,000). Using a four-year average should result in

22   a proforma adjustment of (-$42,000), resulting in proforma expense of $226,000.

23   **<u>Broker Fees</u>**

1   **Q.**   **What are Broker Fees?**

2   **A.**   Broker Fees are fees the Company pays to third party middlemen who put

3 together buyers and sellers. It is a relatively minor expense ($65,000 in 2004) but relates to a

4 vital service by providing market liquidity.

5   **Q.**   **What is Mr. Lott's recommended adjustment to Broker Fees in the**

6 **proforma?**

7   **A.**   Mr. Lott's adjustment would decrease broker fees by $30,000 from the 2004 test-

8 year. The Company's proforma included a $13,000 increase, so Mr. Lott's adjustment is a

9 decrease of $43,000 from the amount included in the proforma.

10   **Q.**   **Does Mr. Lott's adjustment to Broker Fees suffer from the same errors as**

11 **his short-term wheeling adjustment?**

12   **A.**   Yes. Mr. Lott makes the same error as he does in determining his short-term

13 wheeling expense adjustment by comparing modeled short-term purchase and sales volumes to

14 actual purchases and sales volumes. Because the modeled purchase and sales are only 57

15 percent of the actual test-year purchases and sales, he presumes that broker fees should only be

16 57 percent of the test-year level. That logic is not valid as I explained in regards to determining

17 short-term wheeling expense. Modeled short-term purchases and sales are only a fraction of

18 what actually occurs because models have perfect liquidity and foresight. In reality, the volumes

19 of short-term purchases and sales are much higher than the modeled volumes, thereby resulting

20 in higher broker fees.

21   Looking back over the past five years, the five-year average of broker fees is $93,000.

22 Keeping with Mr. Lott's logic of using a three-year average (as he proposed for Garrison-Burke

23 transmission) produces an expense of $79,000. Avista's proforma expense is $78,000. Based on

1   history, it appears reasonable to accept Avista's proforma adjustment that supports a proforma

2   expense of $78,000.

3   **Wanapum**

4   **Q.   What is the Wanapum expense and what adjustment has Mr. Lott proposed?**

5   A.   Wanapum is one of the dams on the Mid Columbia owned by Grant County PUD.

6   Avista purchases 8.2 percent of the project. Avista pays fixed monthly payments for its slice of

7   the project. In the 2004 test-year the total expense was $2,522,000 (system), and is projected to

8   be $3,534,000 (system) in 2006. Mr. Lott proposes that the proforma expense be reduced by

9    $369,000 (system). His adjustment should be rejected because it is based on an arbitrary

10   exclusion of expected O&M expenses and results in a level of 2006 proforma expense that is

11   lower than current actual 2005 expenses.

12   **Q.   What is the Company's proforma expense based on?**

13   A.   The proforma expense is based on Grant County PUD's (the owner of the

14   Wanapum dam) expected costs for Wanapum in 2006. As the owner and operator of the project,

15   Grant PUD is in the best position to establish the expected cost of the project in the proforma

16   year. The cost is based on both debt service and O&M expense.

17

18   **Q.   Are the cost increases at Wanapum unsupported as Mr. Lott claims?**

19   A.   No. Mr. Lott notes, the cost of Wanapum increases by 40% from the 2004 test-

20   year to the 2006 proforma year. While this is unfortunate, it is reality. This is still a very low

21   cost resource (estimated to be $15.20/MWh in 2006). In fact, the majority of this cost increase

22   from the 2004 test-year to the 2006 proforma year has already occurred. Wanapum's cost

23   increased 30 percent from 2004 to 2005.   The additional increase from 2005 actual costs to 2006

1   proforma costs is only 7.5 percent. Mr. Lott's adjustment arbitrarily excludes increases in O&M

2   costs and results in a 2006 proforma level of expense that is lower than the actual expense level

3   in 2005. His recommendation should be rejected.

4   **Garrison-Burke Transmission**

5   **Q.   What is the Garrison-Burke transmission expense?**

6   A.   Garrison-Burke transmission is an expense Avista incurs to wheel Colstrip energy

7   to its system that is in excess of what can be wheeled under Avista's long-term firm transmission

8   from Colstrip. It varies from year to year based on Colstrip generation and outages or deratings

9   of the long-term firm transmission capability. Typically it is purchased on a non-firm basis, but

10   Avista will reserve capacity and pay a demand charge associated with firm capacity when a

11   planned or forced outage or derating occurs on the firm transmission path from the plant. For

12   example, during June 2005, Avista paid demand charges for firm Garrison-Burke transmission to

13   Northwestern Energy because BPA's was working on its Garrison to Taft transmission line. In

14   fact, in every year from 2000 through 2005, Avista has purchased firm Garrison-Burke

15   transmission during some point in the year.

16

17   **Q.   How was the proforma expense determined?**

18   A.   The proforma expense was determined using a five-year average. This was done

19   because the expense varies from year to year. Plus, in the big scheme, the variation in expense is

20   not that great, with the highest year in the five years being $151,000 above the average and the

21   lowest year being $82,000 below the average.

22   **Q.   Do you agree with Mr. Lott's exclusion of two years, 2000 and 2001, and**

23   **instead proposing a 3-year average?**

1   A.   No. His basis for excluding those years is not reasonable. He excludes the year

2   2001 to be consistent with the Oasis Revenue adjustment. There is no logical basis for excluding

3   2001, as there is no relationship between Garrison-Burke transmission expense and Oasis

4   Revenue. The energy crisis in 2001 had no effect on Garrison-Burke transmission expense since

5   the expense only varies by the amount of Colstrip power transmitted and not on market energy

6   prices.

7   Mr. Lott's rationale for excluding the year 2000 from the five-year average is also not

8   reasonable. He states that he excluded the year 2000 because in October of 2000 "there may

9   have been some other abnormal firm amounts included." (page 52, line 16) However, as stated

10   earlier, those firm demand charges have occurred every single year in the five years used to

11   develop the proforma expense (2000 through 2004). They are a normal component of the

12   Garrison-Burke expense. If they aren't included in the Garrison-Burke transmission expense,

13   they would have to be included in short-term wheeling expense. The expense doesn't just

14   disappear, as Mr. Lott's adjustment would suggest.

15

16   **Q.   What is your recommendation for Garrison-Burke wheeling expense?**

17   A.   Mr. Lott's recommended adjustment should be rejected. His adjustment is based

18   on a three-year average that has no reasonable basis. I would also note, that once again, Mr. Lott

19   proposes an adjustment that results in a proforma expense that is less than the actual 2005

20   expense. His adjustment results in a proforma expense of $175,000. Through August 2005,

21   Avista's actual Garrison-Burke expense was $211,000. Mr. Lott's adjustment should be

22   rejected.

23   **Rathdrum Lease**

1   **Q.   What is Mr. Lott's proposed adjustment to the Rathdrum Lease expense?**

2   A.   Mr. Lott's adjustment decreases the lease expense by $577,000 (system)

3   compared to the proforma. His adjustment is based on an amortization of the remaining lease

4   balance over the remaining life of the lease at an interest rate of 6.85 percent.

5   **Q.   Please explain what the Rathdrum lease is and what caused the increase in**

6   **the Rathdrum lease expense from the 2004 test-year to 2006.**

7   A.   Rathdrum is a two-unit simple cycle combustion turbine facility located in

8   Rathdrum, Idaho. Avista constructed these units and placed them in service in 1995. These

9   units were financed through a lease arrangement. During the 2004 test-year the Company was

10   making interest-only payments on the Rathdrum lease principal balance. The financial

11   arrangements under the lease were set to expire in the fall of 2005. At the time the proforma was

12   developed, the Company expected to adjust the financial arrangements under the lease to change

13   from an interest-only lease to a lease that included both interest and principal payments. The

14   proforma was based on an amortization of the lease balance over the remaining life of the lease

15   at the then-current interest rate in the lease of 8.3629 percent.

16   **Q.   How have the plans to adjust the Rathdrum lease changed from what was**

17   **included in the proforma?**

18   A.   The Company recently announced plans to buy out the Rathdrum turbine lease.

19   In the current low interest rate environment, it would be less costly in the long-term to buy out

20   the lease than to extend the financial arrangements under the lease. In the near-term, the costs

21   associated with the buy-out will be higher, but in the long-term the overall costs, on a present

22   value basis, will be lower.

1   **Q.   Why is the Company's Rathdrum Lease expense included in the proforma**

2   **more appropriate?**

3   A.   Based on a 25 year depreciation schedule and the cost of capital included in the

4   Settlement, the first year revenue requirement for the Rathdrum plant would be $1,232,000

5   higher (Washington allocation) than the lease amount included in the proforma as shown on line

6   56 of Exhibit No. (WGJ-2). Exhibit No. ____(WGJ-7) shows the change in revenue requirement

7   for rate base treatment of the Rathdrum plant versus the proforma lease expense included in the

8   Company's original filing. Therefore, <u>even with</u> the lease amount included in the proforma, the

9   Company will be in a position of <u>under-recovering</u> its revenue requirements associated with the

10   Rathdrum plant.

11   Mr. Lott's adjustment to the Rathdrum lease expense should be rejected since it will

12   exacerbate the under-recovery of the revenue requirement associated with a buy-out of the

13   Rathdrum lease, even though, in the long run, the buy-out will be a benefit to customers.

14   **Kaiser DES Revenue**

15   **Q.   What is DES revenue?**

16   A.   DES is the abbreviation for "dynamic energy services," which is another name for

17   load regulation. Kaiser's Trentwood facility is "electronically" in Avista's control area. That

18   means that, although we do not provide the power to serve Kaiser's load, we do provide the

19   services that match their scheduled energy purchases with their load. Avista uses its system to

20   continuously and instantaneously change our generation to match Kaiser's load to the amount of

21   energy they have scheduled to be delivered to our system to serve their load. For this service,

22   Avista charges Kaiser a fixed fee based on their average load. In addition, because scheduled

1   energy and load never perfectly match, Avista will, at any moment, be either supplying

2   additional energy to Kaiser when their scheduled energy is lower than their load, or absorbing

3   scheduled energy that exceeds their load. This energy is called "deviation energy," in that

4   scheduled energy deliveries deviate from their load. Energy amounts in the deviation account at

5   the end of each month are priced out at the market price using the Dow Jones Mid C index

6   prices. In this way, there is no financial gain or loss to either Avista or Kaiser resulting from

7   deviation energy. Ideally, schedules come close to matching load over a longer period, such as a

8   year, and there is very little net deviation energy expense or revenue. However, in 2004 Kaiser

9   chronically under-scheduled and Avista ended up with substantial deviation energy revenue.

10   Because that energy was priced at the market price, however, there was no net financial gain to

11   Avista from supplying that energy. Avista incurred the expense to serve the deviation energy,

12   and received revenue from Kaiser to cover the cost, resulting in no net gain for this component

13   of the service agreement.

14

15

16   **Q.   How does this tie into Mr. Falkenberg's adjustment to Kaiser DES Revenue?**

17   A.   Mr. Falkenberg recommends that 2006 proforma revenue be the same as the 2004

18   test-year. This seems to be a simple misunderstanding of what is in the 2004 test-year revenue.

19   In the 2004 test-year, the fixed DES charge was $57,000 of the total $388,000 in revenue. The

20   remaining $331,000 in revenue in the test-year was from the sale of deviation energy, that is

21   energy that Avista sold to Kaiser as a result of scheduled energy being less than Kaiser's load.

22   As explained in our response to ICNU Data Request No. 4.5, deviation energy revenue is

23   not included in the proforma because deviation energy is priced at market rates so any revenue

1   would exactly <u>be offset</u> by an equal expense related to the energy obligation. The revenue net of

2   expenses in the proforma is always $0. The proforma doesn't include the revenue <u>or</u> expense of

3   deviation energy since they will mathematically always <u>exactly offset</u>.

4   Therefore, Mr. Falkenberg's adjustment to include the test year deviation energy revenue

5   in the proforma is simply wrong. The proforma revenue ($69,000) represents the fixed charges

6   to Kaiser for DES services and properly reflects the only true <u>net</u> revenue from the Kaiser DES

7   contract. Mr. Falkenberg's adjustment should be rejected.

8   **Production Property Adjustment**

9   **Q.   Mr. Lott proposes a production property adjustment to capture the**

10 **estimated benefit of future load growth. Doesn't the revenue credit in the ERM deferral**

11 **calculation already capture this benefit for customers?**

12   A.   Yes. The revenue credit in the deferral calculation accounts for the load

13 difference between what is recorded in the current period compared to the test year. This

14 difference is then multiplied by average production-related revenue per kWh embedded in

15 customer rates.

16   **Q.   What do you mean by "average production-related revenue"?**

17   A.   Revenue from customer rates is summarized by functional category in the cost of

18 service study. The cost elements recovered in rates are represented in this summary including a

19 proportional share of return on rate base as well as income taxes and revenue related expenses.

20 The production category captures all items in the cost of service study that were identified as

21 related to the production function, including return on production rate base. Ms. Knox provides

22 testimony on how this value is derived.

23   **Q.   How does this serve to function like a production property adjustment?**

1   A.   Total production cost per kWh embedded in existing rates is being applied to

2   every incremental kWh of load growth. The resulting value is credited back to customers as a

3   reduction in power costs eligible for deferral. Through this process, actual changes in load are

4   tracked and the benefit of incremental revenue associated with that load flows back to customers.

5   The example below shows how the ERM returns the benefit of load growth back to

6   customers and prevents the Company from over-recovery of the fixed cost of production plant

7   due to load growth.

<div align="center">

Production Cost Example
Why ERM Eliminates Need for Production Property Adjustment

</div>

Authorized Production Costs Based on 2004 Test Year Load		
2004 Test Year Load (aMW)		1,000
Fixed Cost of Production Plant		$131,400,000
Variable Production Cost ($/MWh)	$20	$175,200,000
Total Production Cost		$306,600,000
Average Total Production Cost ($/MWh)		$35.00

2006 Proforma Year without ERM		
2006 Proforma Year Load (aMW)		1,050
Fixed Cost of Production Plant		$131,400,000
Variable Production Cost ($/MWh)	$20	$183,960,000
Total Production Cost		$315,360,000
Average Total Production Cost ($/MWh)		$34.29
Production Costs Recovered in Retail Revenue		$321,930,000
Over (Under) Recovery of Fixed Cost of Production Plant Before ERM		**$6,570,000**

2006 Proforma Year with ERM	
2006 Proforma Year Load (aMW)	1,050
Increase in Retail Load (aMW)	50
Change in Variable Cost Due to Load Growth	$8,760,000
Retail Revenue Credit of Total Production Costs	-$15,330,000
Retail Revenue Credit of Variable Production Costs	-$8,760,000
Retail Revenue Credit of Fixed Production Costs	-$6,570,000
Over (Under) Recovery of Fixed Cost of Production Plant After ERM	**$0**

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1   The top block in the example shows the average total cost of production at $35/MWh

2   based on the 2004 test-year loads (these figures are for illustrative purposes only). This is the

3   retail revenue credit that is applied to load growth in the ERM.

4   The middle block in the example shows what happens in 2006 if there is 50 average

5   megawatts of load growth above the 2004 test-year loads and there is no ERM retail revenue

6   adjustment. Because the fixed cost of production plant does not increase from 2004 to 2006, the

7   average fixed cost of production plant decreases from $35/MWh to $34.29/MWh, because fixed

8   costs are spread out over higher sales. Base retail rates, however, still allow recovery of average

9   total production costs of $35/MWh. In this example, absent the retail revenue credit in the ERM,

10 higher sales would lead to an over-recovery of the fixed cost of production plant of $6,570,000.

11   The bottom block in the example shows how the ERM retail revenue credit of the total

12 production costs returns the $6,570,000 of over-recovery of the fixed cost of production plant

13 back to customers. The retail revenue credit in the ERM prevents the Company from keeping

14 the portion of retail revenue from load growth that recovers the fixed cost of production plant

15 that is included in base rates.

16   **Q.   Are there any other reasons that Mr. Lott's production factor adjustment**

17 **should be rejected?**

18   A.   Yes. Mr. Lott's adjustment is based on an assumed rate of load growth that, even

19 though it is from Avista's Integrated Resource Plan, is still just a projection. If actual load

20 growth is less than the projected rate, then Mr. Lott's adjustment is overstated. The ERM

21 revenue credit, on the other hand, is based on the actual load growth. Since they both are

22 intended to the prevent the over-recovery of fixed cost of production plant due to load growth,

23 the methodology that relies on actual loads rather than forecasted loads should be used.

1 **Q.   Have there, in fact, been retail revenue credits in the ERM that have**

2 **effectively operated as a production property adjustment to account for load growth?**

3   A.   Yes. During the past two years, 2003 and 2004, the ERM revenue credits have

4 been $2,146,840 and $3,660,425 respectively. This demonstrates that the retail revenue credit

5 feature of the ERM is working as intended and is preventing the Company from over-recovering

6 its cost of production.

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8   **Q.   Does that conclude your rebuttal testimony?**

9   A.   Yes.

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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-050482

EXHIBIT NO. _____ (WGJ-7)

WILLIAM G. JOHNSON

REPRESENTING AVISTA CORPORATION

Avista Utilities
Rathdrum Purchase
Change in Revenue Requirement
Rate Base Treatment vs. Pro Forma Lease

	System	Washington 65.16%
Remove pro forma lease - principal & interest	-$6,729	-$4,385
Add depreciation expense (full year, 25-year life)	2,250	1,466
Total expenses	-4,479	-2,919
Net operating income before FIT	4,479	2,919
FIT @ 35%	-1,568	-1,022
Net operating income	$2,911	$1,897

Rate base
Production plant	$56,260	$36,659

Accumulated depreciation
Balance at beginning of period	$0	$0
Balance at end of period	$2,250	$1,466
Total	$2,250	$1,466
Average	$1,125	$733

Net rate base adjustment	$55,135	$35,926

Revenue Requirement
Rate base		$35,926
Rate of return		9.11%
Net operating income (NOI) requirement - return		$3,273
NOI requirement - 35% FIT on debt interest @ 4.85%		-610
NOI requirement - depreciation less pro forma lease expense		-1,897
Total NOI requirement		$766
Conversion factor		0.621611
Revenue requirement		$1,232