Exhibit No. ___(MPG-14T)
Docket Nos. UE-050482 and UG-050483
Witness: Michael Gorman

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	
Complainant,	)	**Docket No. UE-050482**
vs.	)	**Docket No. UG-050483**
AVISTA CORPORATION,	)	*(consolidated)*
Respondent.	)	

REBUTTAL TESTIMONY OF MICHAEL GORMAN

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

September 22, 2005

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael Gorman and my business address is 1215 Fern Ridge Parkway, Suite 208, St. Louis, MO 63141-2000.

Q. ARE YOU THE SAME MICHAEL GORMAN WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I will respond to the Joint Testimony of Kelly O. Norwood, Brian Hirschkorn, Roger Braden, Mike Parvinen, Hank McIntosh, Joelle Steward, Donald Schoenbeck, and Charles Eberdt, (referred to hereafter as the "Joint Witnesses") concerning the proposed Settlement Agreement's rate of return, return on common equity ("ROE") and Equity Building Mechanism ("EBM").

Q. PLEASE DESCRIBE THE JOINT WITNESSES' SUPPORT FOR THE REASONABLENESS OF THE OVERALL RATE OF RETURN INCLUDED IN THE SETTLEMENT AGREEMENT.

A. The Joint Witnesses state that the Signing Parties have agreed to a revenue requirement that produces an overall rate of return of 9.11%, which is based on a return on equity of 10.4% and a 40% common equity ratio in developing the settlement revenue deficiencies. Joint Testimony at 10. In support of this rate of return, the Joint witness made the following statements. First, they state that the settlement overall rate of return is a reduction from Avista's (or the "Company") proposed 9.67% overall rate of return, which is based on an 11.5% return on equity and a 44% common equity ratio. Id.

Second, the Joint Witnesses state that the 10.4% return on equity is comparable to the return on equity of Puget Sound Energy's last authorized return of 10.3%, Avista's Idaho authorized return on equity of 10.4%, and the 10% return on equity awarded to PacifiCorp in Oregon. Id. at 14.

Finally, the Joint Witnesses state that the 10.4% return on equity is reasonable in comparison to the average authorized return on equity by state regulatory commissions nationwide for the first six months of 2005 (10.36% for electric utilities, and 10.56% for natural gas utilities). Id.

Q. HAVE THE JOINT WITNESSES SUPPORTED THE REASONABLENESS OF THE SETTLEMENT AGREEMENT'S OVERALL RATE OF RETURN?

A. No. As I indicated in my direct testimony, the settlement ROE is above Avista's current cost of equity and is not just and reasonable. My finding is supported by the current cost of common equity estimate and recommendation made by Public Counsel witness Stephen Hill. Exhibit No.___(SGH-1T).

Moreover, the Joint Witnesses fail to make an apples to apples comparison of recent authorized equity returns. Significantly, the recent authorized returns for PSE and PacifiCorp cited by the Joint Witnesses in the Pacific Northwest, and typically across the country in 2005, are based on the utilities' actual or reasonable projections of the test year common equity balance. In significant contrast, the Settlement Agreement provides a 10.4% return on a highly inflated hypothetical equity balance, which significantly increases Avista's return on equity opportunity on its actual common equity to well above the returns found reasonable in the Pacific Northwest and around the country.

Specifically, Avista states that its end of year 2004 actual common equity ratio is 27%. However, the settlement rates will be set in this proceeding to produce a 10.4% return on a 40% common equity ratio. As a result, the settlement rates will provide Avista an opportunity to earn a 12.9% return on equity on its actual 27% common equity ratio invested in utility operations. This calculation is developed on my Exhibit No.____(MPG-15). Hence, the settlement rates provide Avista a return on actual common equity that is significantly higher than authorized common equity returns in the Pacific Northwest and around the country. This inflated common equity return opportunity on actual common equity is not just and reasonable.

Q. DO YOU HAVE ANY COMMENTS CONCERNING THE JOINT WITNESSES' SUPPORT FOR THE EBM?

A. Yes. The Joint Testimony fails to provide firm commitments from Avista that the significantly enhanced internal cash flow produced by the settlement rates will be used to pay down debt and achieve the EBM equity ratio targets. Rather, it is possible that Avista will instead use the inflated common equity return on actual common equity to increase dividends to public shareholders, thus diminishing its ability to accelerate the pay down of debt.

The Joint Witnesses simply state that the Settlement Agreement is intended to produce enough internal cash flow to allow the Company to increase its utility equity component through retained earnings and reductions in outstanding levels of long-term debt. Joint Testimony at 12. This internal cash flow from the settlement rates is also enhanced as by the proposal to increase the surcharge recovery of the Energy Recovery Mechanism ("ERM") deferred balance by $2.7 million per year. This increased ERM surcharge will accelerate the recovery of the ERM power cost deferred balance of approximately $100 million and is an important element to growing the utility equity component. Id. at 28.

Importantly, as quantified below, the combination of using a hypothetical common equity ratio and increasing the ERM surcharge increases the settlement electric and gas revenue requirement by $12.6 million.

Q. HAVE THE JOINT WITNESSES DEMONSTRATED THE REASONABLENESS OF THE SETTLEMENT REVNUE REQUIREMENT AND RATES?

A. No. The settlement revenue requirement is not based on Avista's actual cost of service but rather is instead designed to help generate enough internal cash to allow Avista to accelerate the pay-down of debt and build up its common equity ratio. Again, it is important to note that the Settlement Agreement does not include a firm commitment from Avista to use the enhanced settlement cash flow for debt reduction, nor is there a commitment to provide a direct payback to customers for this financial restoration revenue rate plan.

Q. HOW MUCH OF THE SETTLEMENT REVENUE REQUIREMENT EXCEEDS AVISTA'S CURRENT COST OF SERVICE AND REPRESENTS CUSTOMER-FUNDED FINANCIAL RESTORATION?

A. The Settlement Agreement inflates customers' rates and Avista's internal cash flow by developing an overall rate of return based on a common equity ratio that is significantly in excess of the Company's actual common equity ratio. As shown on my Exhibit No.___(MPG-16), the Settlement Agreement's use of an imputed common equity ratio of 40% increases the settlement revenue requirement by $8.6 million on electric operations, and $1.4 million on gas utility operations compared to using Avista's actual 27% common equity ratio. Hence, the imputed common equity ratio would increase Avista's electric and gas combined revenue requirement by $9.986 million.

Increasing the ERM surcharge amortization cost recovery by $2.7 million per year increases the settlement revenue requirement in total by approximately $12.6 million for both electric and gas operations.

Q. HOW DO YOU RECOMMEND THE COMMISSION MODIFY THE SETTLEMENT AGREEMENT?

A. As stated in my direct testimony, at a minimum, I recommend the Settlement Agreement be modified to reduce the revenue requirement to provide a 9.8% return on common equity on the proposed hypothetical common equity ratio. This return on equity fairly compensates Avista for its low risk regulated operations. Second, I recommend the settlement EBM should contain a firm commitment from Avista to use the enhanced settlement earnings and cash flow to fund debt reduction and not increase its dividend payments to public shareholders during the settlement rate period.

Q. IF THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION APPROVES THE SETTLEMENT REVENUE REQUIREMENT, SHOULD IT MODIFY THE TERMS OF THE SETTLEMENT AGREEMENT?

A. Yes. The terms of the Settlement Agreement should be modified to ensure the public interest is protected. This would require two changes to the terms of the Settlement Agreement regarding earnings and the EBM.

First, as stated above, Avista should make a firm commitment not to increase dividends during the settlement rate period and to use the enhanced earnings and cash flow to pay down debt.

Second, the Settlement Agreement should be modified to provide a quid pro quo to customers for paying rates that exceed Avista's current cost of service. That is, if customers are forced to pay higher rates today, they should receive the benefit of lower rates in future proceedings. This can be accomplished by modifying the Settlement Agreement to provide a fair return on Avista's actual common equity ratio and using the Settlement Agreement's higher revenue requirement to accelerate the amortization of the ERM deferral balance. Accelerating the amortization of the deferral balance will reduce Avista's cost of service in future rate proceedings because the ERM unrecovered balance will be reduced. This, in turn, will lower future rates by the reduction or elimination of the ERM amortization surcharge. Avista's ability to pay down debt during the rate settlement period will not be changed because the enhanced cash flow produced by the settlement rates would not change.

ICNU requests that the Settlement Agreement be rejected; however, if the Commission adopts the Settlement Agreement, including the proposed increase in revenue requirement, I recommend that the Settlement Agreement be modified as follows:

1. The authorized return on equity should be set at 9.8%, not 10.4%.

2. The amortization of the ERM deferral balance should be increased by an additional $12.4 million (as developed on my Exhibit No.___(MPG-17)) at the time settlement rates are approved. This represents the difference between the settlement revenue requirement, and the lower cost using a 9.8% common equity return and Avista's actual common equity ratio.

3. The ERM surcharge should be increased during the period of the settlement to include interest rates savings produced as Avista's high cost debt is paid down or refinanced at lower interest rates.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.