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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

| | |
|------------------------------------|----------------------|
| IN THE MATTER OF THE APPLICATION) | CASE NO. AVU-E-10-01 |
| OF AVISTA CORPORATION FOR THE) | CASE NO. AVU-G-10-01 |
| AUTHORITY TO INCREASE ITS RATES) | |
| AND CHARGES FOR ELECTRIC AND) | |
| NATURAL GAS SERVICE TO ELECTRIC) | DIRECT TESTIMONY |
| AND NATURAL GAS CUSTOMERS IN THE) | OF |
| STATE OF IDAHO) | SCOTT L. MORRIS |
|) | |

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

1 I. INTRODUCTION

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

4 A. My name is Scott L. Morris and I am employed as
5 the Chairman of the Board, President and Chief Executive
6 Officer of Avista Corporation (Company or Avista), at 1411
7 East Mission Avenue, Spokane, Washington.

8 Q. Would you please briefly describe your educational
9 background and professional experience?

10 A. Yes. I am a graduate of Gonzaga University with a
11 Bachelors degree and a Masters degree in organizational
12 leadership. I have also attended the Kidder Peabody School
13 of Financial Management.

14 I joined the Company in 1981 and have served in a
15 number of roles including customer service manager. In
16 1991, I was appointed general manager for Avista Utilities'
17 Oregon and California natural gas utility business. I was
18 appointed President and General Manager of Avista Utilities,
19 an operating division of Avista Corporation, in August 2000.
20 In February 2003, I was appointed Senior Vice-President of
21 Avista Corporation, and in May 2006, I was appointed as
22 President and Chief Operating Officer. Effective January 1,
23 2008, I assumed the position of Chairman of the Board,
24 President, and Chief Executive Officer.

Morris, Di 1
Avista Corporation

1 I am a member of the Western Energy Institute board of
2 directors, a member of the Gonzaga University board of
3 trustees, a member of Edison Electric Institute board of
4 directors, a member of the American Gas Association board of
5 directors, a member of ReliOn board of directors, and board
6 director of the Washington Roundtable. I also serve on the
7 board of trustees of Greater Spokane Incorporated.

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

10 A. I will provide an overview of Avista Corporation.
11 I will also summarize the Company's rate requests in this
12 filing, the primary factors driving the Company's need for
13 general rate relief, and provide some background on why
14 utility costs are continuing to increase. In addition to
15 major increases in power supply costs, the Company continues
16 to experience increasing costs from additional compliance
17 requirements, and the need to replace aging infrastructure.
18 It is simply not possible to cut other costs enough to
19 offset these cost increases.

20 My testimony will provide an overview of some of the
21 measures we have taken to cut costs, as well as initiatives
22 to increase operating efficiencies in an effort to mitigate
23 a portion of the cost increases. I will briefly explain the
24 Company's customer support programs in place to assist our

1 customers, as well as our communications initiatives to help
2 customers better understand the changes in costs that are
3 causing our rates to go up. Finally, I will introduce each
4 of the other witnesses providing testimony on the Company's
5 behalf.

6 A table of contents for my testimony is as follows:

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18 **Q. Are you sponsoring any exhibits in this**
19 **proceeding?**

20 A. Yes. I am sponsoring Exhibit No. 1 pages 1 and 2.
21 Page 1 is a diagram of Avista's corporate structure; and
22 page 2 includes a map showing Avista's electric and natural
23 gas service areas. This exhibit was prepared under my
24 direction.

25

26

II. OVERVIEW OF AVISTA

27 **Q. Please describe Avista's current business focus**
28 **for the utility and subsidiary operations.**

1 A. Our strategy continues to focus on our energy and
2 utility-related businesses, with our primary emphasis on
3 the electric and natural gas utility business. There are
4 four distinct components to our business focus for the
5 utility, which we have referred to as the four legs of a
6 stool, with each leg representing customers, employees, the
7 communities we serve, and our financial investors. For the
8 stool to be level, each of these legs must be in balance by
9 having the proper emphasis. This means we must maintain a
10 strong utility business by delivering efficient, reliable
11 and high quality service at a reasonable price to our
12 customers and the communities we serve, and provide the
13 opportunity for sustained employment for our employees,
14 while providing an attractive return to our investors.

15 **Q. Please briefly describe Avista's subsidiary**
16 **businesses.**

17 A. Avista Corp.'s primary subsidiary is the
18 information and technology business, Advantage IQ,
19 described below, which is headquartered in Spokane,
20 Washington. In 2007, Avista completed the sale of the
21 operations of Avista Energy to Coral Energy Holding, L.P.
22 Avista currently holds a 6.8% share in Avista Labs'
23 successor company, ReliOn, which is held under Avista

1 Capital. A diagram of Avista's corporate structure is
2 provided on page 1 of Exhibit No.1, Schedule 1.

3 **Q. Please provide an overview of Advantage IQ.**

4 A. Advantage IQ, formerly known as Avista Advantage,
5 commenced operations in 1998 and is a provider of utility
6 bill processing, payment and information services to multi-
7 site customers. Advantage IQ analyzes and presents
8 consolidated bills on-line, and pays utility and other
9 facility-related expenses for multi-site customers
10 throughout North America. Customers include, CSK Auto, Jack
11 in the Box, Staples, and Big Lots, to name a few.
12 Information gathered from invoices, providers and other
13 customer-specific data allows Advantage IQ to provide its
14 customers with in-depth analytical support, real-time
15 reporting and consulting services with regard to facility-
16 related energy, waste, repair and maintenance, and telecom
17 expenses. In 2007, 2008 and 2009, Advantage IQ was awarded
18 the ENERGY STAR® Sustained Excellence Award and in 2010,
19 received the Energy Management Award in recognition of its
20 continued leadership in protecting our environment through
21 energy efficiency.

22 **Q. Please briefly describe Avista Utilities.**

23 A. Avista Utilities provides electric and natural gas
24 service within a 26,000 square mile area of northern Idaho

1 and eastern Washington. Of the Company's 356,620 electric
2 and 316,350 natural gas customers (as of December 31, 2009),
3 122,358 and 74,006, respectively were Idaho customers. The
4 Company, headquartered in Spokane, also provides natural gas
5 distribution service in southwestern and northeastern
6 Oregon. A map showing Avista's electric and natural gas
7 service areas is provided on page 2 of Exhibit No. 1,
8 Schedule 1.

9 As of December 31, 2009, Avista Utilities had total
10 assets (electric and natural gas) of approximately \$3.6
11 billion (on a system basis), with electric retail revenues
12 of \$705 million (system) and natural gas retail revenues of
13 \$397 million (system). As of December 2009, the Utility had
14 1,538 full-time employees.

15 Avista has a long history of innovation and
16 environmental stewardship. At the turn of the 20th century,
17 the Company built its first renewable hydro generation plant
18 on the banks of the Spokane River. In the 1980's, Avista
19 developed an award-winning biomass plant (Kettle Falls) that
20 generates energy from wood-waste.

21 To the future, Avista as well as other utilities are
22 facing new state and federal mandates for renewable energy
23 and carbon control standards. Recognizing these changes, the
24 Company did not model any coal-fired generation in its 2009

1 electric IRP, instead relying on natural gas, renewables,
2 and energy efficiency. Today, Avista has one of the
3 smallest carbon footprints in the U.S.

4 **III. SUMMARY OF RATE REQUESTS**

5 **Q. Please provide an overview of Avista's electric**
6 **rate request in this filing.**

7 A. Avista is proposing an increase in electric billed
8 retail rates of \$32.1 million or 13.1%. The Company's
9 request is based on a proposed rate of return of 8.55% with
10 a common equity ratio of 50% and a 10.9% return on equity.

11 Mr. Ehrbar will provide details related to rate spread
12 and rate design. The proposed rate spread for the increase
13 to each electric customer class is shown in the illustration
14 below.

15 **Illustration No. 1:**

| 16 | | Proposed |
|----|---|-----------------|
| 17 | <u>Service Schedule</u> | <u>Increase</u> |
| 18 | Residential Service Schedule 1 | 14.5% |
| 19 | General Service Schedules 11 & 12 | 13.3% |
| 20 | Large General Service Schedules 21 & 22 | 13.6% |
| 21 | Extra Large General Service Schedule 25 | 11.3% |
| 22 | Clearwater Paper Schedule 25P | 9.4% |
| 23 | Pumping Service Schedules 31 & 32 | 17.1% |
| 24 | Street & Area Lighting Schedules 41-49 | <u>13.3%</u> |
| 25 | Overall Increase | 13.1% |
| 26 | | |

1 Q. What is Avista's natural gas rate request in this
2 filing?

3 A. With regard to natural gas, the Company is
4 requesting an increase of \$2.6 million or 4.1% of billed
5 rates. As with the electric increase, the Company's request
6 is based on a proposed rate of return of 8.55% with a common
7 equity ratio of 50% and a 10.9% return on equity. The
8 proposed rate spread for each natural gas customer class is
9 shown in the illustration below.

10

11 Illustration No. 2:

12

| 13 <u>Service Schedule</u> | Proposed 14 Increase |
|---|-------------------------|
| 15 General Service Schedule 101 | 4.9% |
| 16 Large General Service Schedule 111 | 1.1% |
| 17 Interruptible Sales Service Schedule 131 | 2.2% |
| 18 Transportation Service Schedule 146 | <u>1.9%</u> |
| 19 Overall Increase | 4.1% |

20 Q. What are the primary factors causing the Company's
21 request for an electric rate increase in this filing?

22 A. The Company's electric general rate case test
23 period is based on 12-months ending December 31, 2009, and
24 an October 1, 2010 through September 30, 2011 pro forma
25 period. As shown in Illustration No. 3, the Company's
26 electric request is driven primarily by an increase in
27 production and transmission expenses, due to the addition of

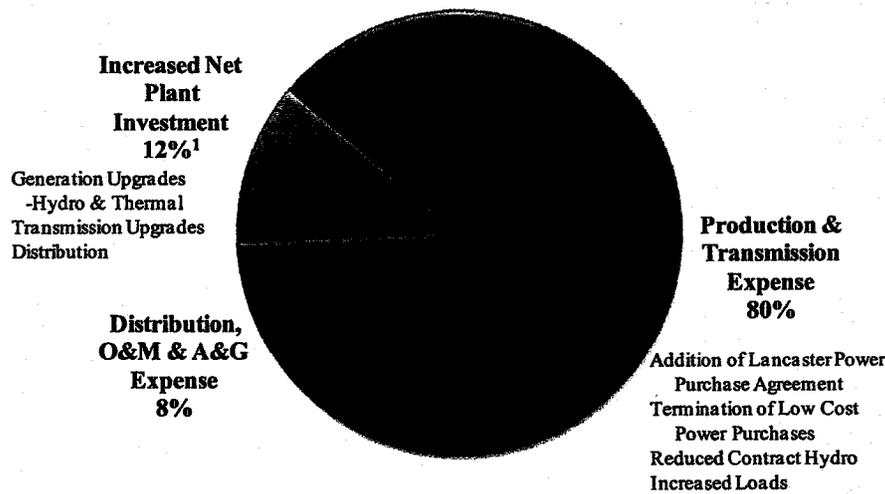
1 the Lancaster plant Power Purchase Agreement (PPA), in base
 2 rates, the termination of some low-cost power purchases,
 3 reduced hydro generation, and increased fuel costs and
 4 higher retail loads. These costs equate to approximately
 5 80% of the Company's overall request. In addition, 12% of
 6 the request is due to the increased net plant investment in
 7 the Company's hydro and thermal generation projects, and
 8 transmission and distribution upgrades.

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Illustration No. 3:

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**Idaho
 Primary Electric Revenue Requirement Factors**



¹Includes return on investment, depreciation and taxes, offset by the tax benefit of interest.

1 Later witnesses provide details explaining these
2 changes in costs.

3 **Q. What are the primary factors driving the Company's**
4 **request for a natural gas rate increase?**

5 A. The Company's natural gas request is primarily
6 driven by the inclusion in this case of the increased plant
7 investment and inventory associated with the transfer of
8 additional capacity and deliverability in the Jackson
9 Prairie Storage facility from Avista Energy to Avista
10 Utilities, effective May 1, 2011. Company witness Mr.
11 Christie discusses the details of this project. Other
12 changes are due to various operating cost components, mainly
13 administrative and general expenditures.

14 **Q. Is the Company proposing any changes to the cost**
15 **of natural gas for its retail natural gas customers in this**
16 **case?**

17 A. No. Avista is not proposing changes in this filing
18 related to the cost of natural gas included in current rates
19 for natural gas customers. Changes in natural gas costs are
20 addressed in the annual purchased gas adjustment (PGA)
21 filings.

22
23
24

1 IV. BACKGROUND FOR PROPOSED RATE CHANGES

2 Q. Would you please provide some background on the
3 changes in costs the Company is experiencing, which are
4 leading to the need for increased rates?

5 A. Yes. Although we would like to avoid any rate
6 increase request under the current economic circumstances,
7 as I will explain later in my testimony we have no other
8 choice. Some of our customers have made the comment that
9 we should "tighten our belt" and cut costs - and we have
10 done that. The fact is we are experiencing major cost
11 impacts such that it is not possible to cut other costs
12 enough to offset them, and still be able to meet mandatory
13 compliance requirements and provide safe, reliable service
14 to our customers.

15 I am going to get into a little more detail in my
16 testimony than I have historically, because as we listen to
17 our customers it is evident that it is even more important
18 now, given the current state of the economy, that we
19 clearly explain to all of our stakeholders the cost changes
20 and circumstances that we are experiencing. And because
21 technology today allows all of our stakeholders ready-
22 access to this testimony and the other documents of our
23 filing, we are hopeful that the additional detail and
24 explanation will promote a better understanding by all

1 stakeholders of why it is necessary for us to request a
2 rate increase at this time.

3 **Q. Why is it necessary to file a rate increase**
4 **request?**

5 A. The Company is experiencing major increases in
6 power supply costs, as well as increased costs from
7 additional compliance requirements, and the need to
8 continually replace aging infrastructure. The current
9 ratemaking process employed by the Commission is to
10 establish new retail rates for only the one upcoming year
11 that the new rates will be in effect. The process does not
12 allow recovery of costs beyond that first year. The only
13 way to recover increasing costs to serve customers is to
14 file a new rate request every year.

15 **Q. Do other states have ratemaking processes that**
16 **set rates for multiple years, so that an annual rate filing**
17 **is not necessary?**

18 A. Yes. Some states use formula-based or multi-year
19 rate making mechanisms to avoid rate filings every year.
20 For example, in the state of California, the CPUC in 2008
21 approved multi-year settlements in Southern California Gas
22 Company's general rate case (Application 06-12-010), which
23 provided a \$59 million rate increase in 2008, \$52 million
24 in 2009, \$51 million in 2010, and \$53 million in 2011. The

1 CPUC order directed SCG to file in 2010, two years later,
2 to address cost recovery beginning in 2012.

3 The use of formula-based or multi-year ratemaking
4 would reduce the administrative burden for regulators and
5 the Company associated with filing cases every year. It
6 would also reduce frustration for customers who see not
7 only news of annual rate filings, but also multiple news
8 stories within the same year for the same rate case related
9 to the Company's rate proposals. There is media coverage on
10 Commission Staff and intervener proposals, proposals on
11 rebuttal, and finally another news story following the rate
12 decision by the Commission.¹ The multi-year mechanisms can
13 include protections for both customers and the Company to
14 ensure that there is not a material over-recovery or under-
15 recovery of costs during the multi-year period.

16 Although we have not proposed a multi-year mechanism
17 in the current filing, I am hopeful that we can work
18 together collaboratively in the future toward some solution
19 to avoid these types of filings year after year.

20 **Q. What is the nature of the cost changes that have**
21 **caused the Company to file this rate request?**

¹Due to this confusion, often some customers believe we have multiple increases in a single year because of these multiple media stories.

1 A. Let me give you a couple of examples. As Mr.
2 Storro explains in his testimony, we currently have 100 aMW
3 of purchased power agreements that began in 2004 and end on
4 December 31, 2010. Our average retail load is
5 approximately 1,100 aMW, so the 100 aMW supplies a
6 meaningful portion (9%) of our customers' load. The cost
7 of these agreements is approximately 3 cents per kWh, which
8 is well below the cost to replace this power. The
9 expiration of these contracts alone will increase our power
10 supply costs by approximately \$10 million on a system
11 basis, which equates to a rate increase to customers of
12 approximately 1.6%. These contracts have provided
13 substantial benefits to our customers since 2004, but will
14 expire at the end of this year.

15 A second example is the addition of the Lancaster
16 Project generation to our system. While Lancaster is a
17 very low cost resource compared to other resource
18 alternatives available to us, its cost is higher than our
19 existing low-cost resource base, which results in increased
20 costs to serve our customers. The net additional cost
21 associated with Lancaster is approximately \$21 million per

1 year, which equates to a rate increase to customers of
2 approximately 3.3%².

3 I want to emphasize the impacts that resource changes
4 can have on our total resource costs, because we are a low-
5 cost utility. For example, if a utility with a resource
6 portfolio having an embedded cost of power of 7 cents per
7 kWh, adds a new resource with a cost of 7 cents per kWh, it
8 would result in essentially no rate increase to customers,
9 because the cost of the new resource is the same as the
10 cost already built into base rates. However, Avista's
11 embedded cost of resources to serve customers is
12 approximately 4.3 cents/kWh. Therefore, the addition of a
13 new long-term firm resource at 7 cents/kWh would result in
14 an increase in costs, and rates, to our customers.

15 Although our low-cost resource base is a substantial
16 benefit to our customers, when these low-cost resources
17 expire or we need to add new resources, it results in rate
18 increases for our customers. These same resource changes
19 may have little impact on other utilities because they
20 already have higher rates.

² Costs associated with the Lancaster Power Purchase Agreement have been previously found to be prudent by this Commission in AVU-E-09-01, but are presently being recovered through the Company's PCA in Idaho, until such time as such costs are transferred into base rates in this proceeding. (See testimony of Avista Witness Johnson for further discussion.)

1 These two issues alone (expiration of the low-cost
2 contracts, and the addition of the Lancaster Project)
3 represent a rate increase of approximately \$11 million
4 (Idaho share) or 4.8%, which is approximately 34% of the
5 Company's overall request. It is simply not possible to
6 cut other costs enough to offset these kinds of increases.

7 **Q. What else has caused the need to request a rate**
8 **increase?**

9 A. As a regulated company, we operate under what has
10 been referred to as a "regulatory compact." As part of
11 that compact, although we are provided with an opportunity
12 to make a fair profit, that profit is limited by the
13 regulators. And under that same compact we have an
14 obligation to serve all customers with safe, reliable
15 service. When a new customer wants service, we must hook
16 them up, even if the cost to serve that customer results in
17 increased costs to all other customers. Likewise, if the
18 facilities serving an existing customer are deteriorating
19 and need repair, we must repair or replace them so that the
20 customer continues to receive safe, reliable service.

21 As I mentioned earlier, we occasionally receive
22 comments from some of our customers to the effect that
23 Avista should cut its costs, and "tighten its belt," like
24 other businesses are having to do in these difficult

1 economic circumstances, and keep retail rates the same. We
2 hear those comments and take them to heart, but we are not
3 like other businesses. Without the obligation to serve, we
4 could consider refusing to hook up some new customers,
5 because it could avoid a further increase in costs to our
6 existing customers. Without an obligation to serve, we
7 could consider no longer serving some of the more remote,
8 more costly areas to provide service, which would allow us
9 to avoid further investment, and reduce labor and other
10 costs. Unregulated businesses have the opportunity to shut
11 down under-producing retail outlets, eliminate product
12 lines, and cut back on investment, maintenance, and other
13 costs.

14 Please don't misunderstand my point -- we do have
15 opportunities to cut back on investment and operating
16 costs, and we have. I will address that later in my
17 testimony. But those opportunities are limited by our
18 obligation to safely and reliably serve all customers, and
19 our obligation to comply with numerous mandatory state and
20 federal requirements.

21 In recent years there has been a significant increase
22 in costly, mandatory requirements on utilities related to,
23 among others things, reliability, environmental compliance,
24 safety, and security. These mandates, together with

1 litigation and other claims related to the ownership and
2 operation of hydroelectric resources, have added, and
3 continue to add, significant costs to run the utility. The
4 penalties associated with non-compliance with some of these
5 requirements can be as much as \$1 million per day per
6 violation.

7 We simply don't have the choice to say no to new
8 customers, no to maintaining a safe, reliable system, and
9 no to mandatory requirements. Although we have taken
10 extensive measures to ensure that the costs that we incur
11 represent the most cost-effective and reliable way to
12 continue to serve our customers, we continue to experience
13 significant increases in costs.

14 **Q. Can you provide some examples of the state and**
15 **federal mandates and other costs recently imposed on the**
16 **utility?**

17 A. Yes. Most of the larger cost impacts are on the
18 electric side of the utility. Just for context, our
19 electric retail revenues in 2009 (on a system basis) were
20 approximately \$700 million and our average electric rate
21 base for 2009 was approximately \$1.6 billion (system).

22 Under federal law we must have a license to operate
23 our hydro-electric projects to serve customers. In recent
24 years we negotiated new licenses for the projects on both

1 the Clark Fork and Spokane rivers. The cost to gain new
2 licenses was over \$40 million up front and approximately
3 \$600 million over the life of the new licenses (45 to 50
4 years). These costs reflect aggressive bargaining on the
5 part of the Company to keep the costs as low as possible.
6 The requirements in the new long-term licenses address
7 environmental and cultural protection while preserving our
8 low-cost hydroelectric resources for the benefit of our
9 customers, but they also represent significant increases
10 in costs associated with owning and operating our hydro-
11 electric system.

12 In addition, the recent settlement with the Coeur
13 d'Alene Tribe related to the US Supreme Court decision
14 granting the Tribe ownership of the lower one-third of Lake
15 Coeur d'Alene cost \$39 million up front and over \$175
16 million over a 50 year term.

17 Recent claims in Montana related to Avista's use of
18 the bed and banks of the Clark Fork River for hydro-
19 electric generation resulted in costs of over \$47 million
20 for the first 10-year period beginning in 2007, after which
21 the annual amount will be renegotiated. In addition, there
22 are new mercury emission limitation requirements in Montana
23 effective in 2010 related to our ownership interest in the
24 Colstrip Generating Projects that required capital

1 investment up front and annual costs of \$1.5 million per
2 year (Avista share).

3 With regard to reliability requirements, the Energy
4 Policy Act of 2005 changed the national reliability
5 standards for utilities, enforced by the North American
6 Electric Reliability Corporation (NERC), from voluntary to
7 mandatory beginning June 2007. Non-compliance with any of
8 the requirements may result in monetary penalties up to \$1
9 million per day per violation. The reliability standards are
10 focused primarily on system operation, transmission planning
11 and equipment maintenance.

12 The planning standards require utilities to perform
13 planning studies at least 10 years in the future to ensure
14 sufficient facilities are in place to avoid real time loss
15 of customers or impact to neighboring utilities for the loss
16 of transmission facilities. The transmission system must be
17 designed and operated so that the simultaneous loss of up to
18 two facilities will not impact the interconnected
19 transmission system. If a potential violation is observed
20 in the future analysis, then Avista must develop a project
21 plan to ensure that the violation is fixed prior to it
22 becoming a reality. Avista budgets for future projects and
23 ensures that the design and construction of the required
24 projects are completed prior to the time they are needed.

1 The NERC standards require Avista to continually invest in
2 its transmission system to maintain system reliability based
3 on load growth, the addition of new generation, and system
4 configuration changes. These requirements have been, and
5 will continue to be, very costly.

6 Avista has incurred significant O&M costs since 2007 to
7 adhere to the mandatory reliability standards. Several new
8 positions have been added as a result of the NERC
9 reliability standards becoming mandatory. A Compliance
10 Manager and Analyst have been hired to coordinate the
11 Company's compliance program. The Company has also added an
12 additional System Operator to allow adequate time for
13 operator training, a Training Coordinator to train, track
14 and manage all the extensive training needs and continuing
15 education hours required for System Operators to maintain
16 certification, and two additional engineers to support the
17 new Critical Infrastructure Protection standards. Avista
18 was required to construct a redundant Backup Control Center
19 at a cost of approximately \$6 million to meet one of the
20 emergency operating standards. Avista also has
21 approximately 25 subject matter experts that spend anywhere
22 from 10-30% of their time working on compliance initiatives
23 and documentation.

1 I could go on, but I believe the point has been made
2 related to the significant costs associated with the recent
3 mandates and other costs imposed on the Company. And this
4 is prior to talking about new requirements and costs related
5 to mandatory renewable portfolio standards, new and higher
6 energy efficiency requirements, and the potential future
7 costs associated with climate change.

8 **Q. During the 1990s Avista filed for very few changes**
9 **in base retail rates. What were the circumstances that**
10 **allowed Avista to not change rates during that period?**

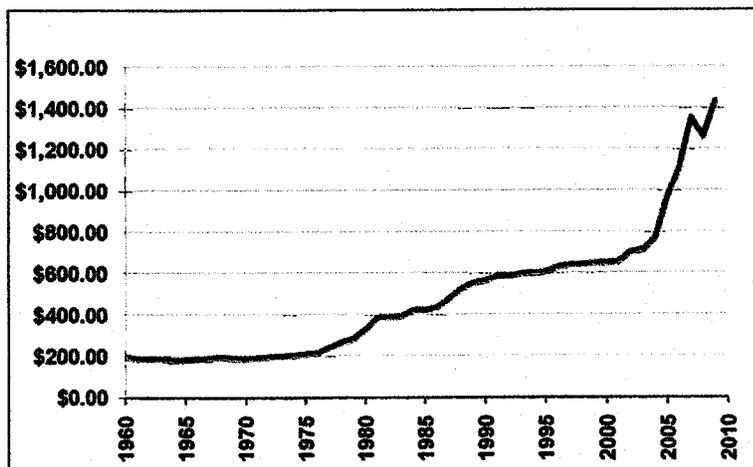
11 A. Avista and other regional utilities had surplus
12 energy during the 1990s, and the wholesale cost of power
13 generally was in the range of 1.5 to 2.0 cents/kWh. As
14 retail loads grew, the incremental cost of power to serve
15 customers was equal to or less than the amount embedded in
16 retail rates, and therefore growing loads did not create
17 retail price pressure. As is evident from the discussion
18 above, we have many more mandates and compliance
19 requirements now than in the 1990s. In addition, our
20 utility infrastructure in the 1990s was generally newer and
21 in better condition, and required less capital investment.
22 The combination of an aging infrastructure and more
23 stringent reliability requirements has resulted in the
24 necessity to invest in generation, transmission and delivery

1 infrastructure to ensure reliability and compliance with new
2 mandates. Finally, among other things, the higher cost of
3 materials for utility equipment today, versus the 1990s, has
4 had a significant impact on the cost to own and operate the
5 utility today.

6 **Q. Has there been a dramatic change in the cost of**
7 **materials in recent years?**

8 A. Yes. One example is the cost of a 15 kVA
9 distribution transformer, which is what is commonly used to
10 step-down the voltage for our residential electric
11 customers. The chart below shows the change in the cost of
12 these transformers for the past 50 years. What is
13 noteworthy is the rapid escalation that has occurred in the
14 more recent years, i.e., the cost has essentially doubled in
15 the last six years.

16 **15 KVA Distribution Transformer**



1 The dramatic escalation in the cost of materials has
2 not been limited to just transformers. Mr. DeFelice
3 provides additional details related to the significant
4 increase in the cost of utility materials and equipment in
5 recent years.

6 In the next five years, our relatively small Company
7 will need to spend approximately \$1.2 billion of capital on
8 utility facilities and other requirements. And this is not
9 including the costs associated with any climate-change
10 requirements. This \$1.2 billion represents 57% of the
11 current rate base of approximately \$2.1 billion serving
12 customers today.

13 Utility equipment and facilities are big and expensive,
14 and the required investment in new facilities is one of the
15 major reasons that we need an increase in retail rates.

16 **Q. In what areas is it necessary for the Company to**
17 **make new investment?**

18 A. We are in the middle of a roughly 10-year schedule
19 to refurbish our Cabinet Gorge and Noxon hydro-electric
20 generating units. We are also performing necessary upgrades
21 to some of our Spokane River projects.

22 The photo below shows Avista crews removing one of our
23 Noxon turbine runners:

24

1 Q. What is the nature of the investment necessary in
2 the electric distribution system?

3 A. Among other electric distribution investment
4 needs, it is necessary for us to replace some of our aging
5 distribution infrastructure. We have over 240,000
6 distribution poles and 34,500 transmission poles in our
7 electric system. As an example, the distribution pole and
8 transformer shown below are pre-1964, and the pole has
9 deteriorated to the point where it needs to be replaced.



1 Each year our existing system gets older and a portion
2 of it must be replaced. And the complexity of our electric
3 system requires us to hire, train and retain highly-skilled
4 and experienced employees to safely and reliably build and
5 maintain our system.

6 In addition to the investment necessary to hook up new
7 customers, and the investment necessary to comply with the
8 reliability requirements I touched on earlier, we must
9 continue to systematically replace our distribution
10 facilities - some of which are 60 to 70 years old.

11 **Q. Does the level of depreciation each year cover**
12 **the cost to replace these facilities?**

13 A. No. Some of our customers suggest to us that we
14 set aside dollars every year to replace these facilities
15 over time - and we do. That is what depreciation is for.
16 The level of annual depreciation dollars built into retail
17 rates is available to the Company to replace aging
18 facilities over time. However, under the "regulatory
19 compact" our retail rates are "cost-based," meaning the
20 annual depreciation is based on the actual historical costs
21 of our electric system. And as I explained earlier, because
22 the cost of our utility facilities decades ago was orders of
23 magnitude less than what it costs to build facilities today,
24 the annual depreciation falls dramatically short of

1 providing the funds necessary to replace facilities today.
2 Therefore, retail rate increases are necessary to cover the
3 higher costs to replace facilities.

4 **Q. Are other utilities facing similar circumstances?**

5 A. Yes. Other retail electric utilities, and their
6 facilities, have been around for a long time and are also
7 experiencing significant increases in costs associated with
8 aging infrastructure.

9 In a February 26, 2010 article in the Spokane area
10 Journal of Business, it was reported that a neighboring
11 public utility, Inland Power & Light (IP&L), will increase
12 rates April 1st by 8.5% related to increased power costs and
13 increased infrastructure costs:

14 Inland Power plans to raise its rates 8.5 percent on
15 April 1, mostly because of the need to pass along a 7
16 percent increase in the wholesale price the co-op pays
17 the Bonneville Power Administration for power, with
18 the rest targeted at system infrastructure upgrades.
19 (emphasis added)
20

21 Kris Mikkelsen, the Chief Executive Officer of IP&L,
22 was quoted in the article as stating:

23 "We don't have a choice' but to raise rates, Mikkelsen
24 says. 'There's no way to absorb that. The hope is
25 that the economy will start to get a little better,
26 and it will be easier for people to deal with."
27

28 A number of other regional utilities have also recently
29 announced rate increases, due in part to the higher cost of

1 owning and operating their utility systems. In the March 1,
2 2010 issue of Clearing Up, an article on page 5 stated as
3 follows regarding Seattle City Light:

4 Cost pressures aren't limited to IOUs. Seattle City
5 Light is a good example. The muni's rates increased
6 by 13.8 percent in January because it needs to replace
7 aging infrastructure and cover a drop in revenues from
8 wholesale energy sales. (emphasis added)
9

10 PacifiCorp recently, on March 2, 2010 filed two
11 electric rate increase requests in the State of Oregon
12 totaling 20% to cover increased investments in
13 infrastructure and higher power supply costs.

14 **Q. You mentioned earlier that Avista is a low-cost**
15 **utility, as compared to other utilities. How do Avista's**
16 **retail rates compare to other utilities in the Northwest**
17 **and across the country?**

18 A. Edison Electric Institute periodically prepares a
19 comparison of residential electric bills for investor-owned
20 utilities across the country. The chart below provides a
21 comparison of an Avista customers' monthly bill³ in Idaho
22 and Washington, with utility bills in other states. The
23 chart shows that Avista's residential customers' rates are
24 the lowest, or are among the lowest, in the country.

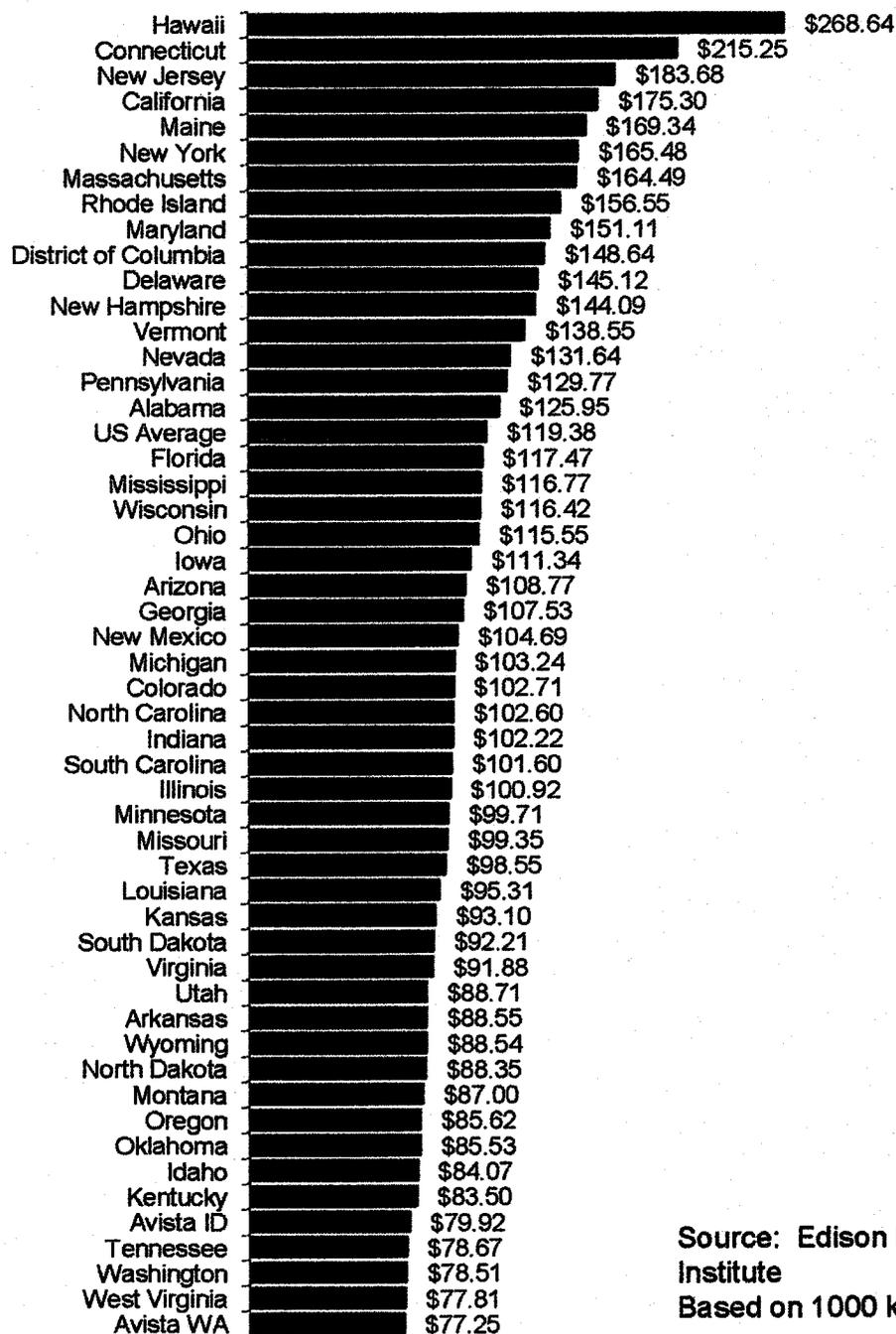
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³ Based on a residential customer's usage of 1,000 kWh per month.

Residential Monthly Electric Bills
Investor-Owned Utilities
July 1, 2009

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Source: Edison Electric
Institute
Based on 1000 kWhs

1 Our low retail rates are due in large part to a history
2 of our Company aggressively pursuing the acquisition and
3 preservation of a diversified portfolio of low cost
4 resources for the benefit of our customers, and controlling
5 costs. This portfolio includes hydroelectric, wood-waste
6 fired, gas-fired baseload, gas-fired peakers, and coal-fired
7 generation, together with long-term purchases of power and
8 an aggressive energy efficiency program.

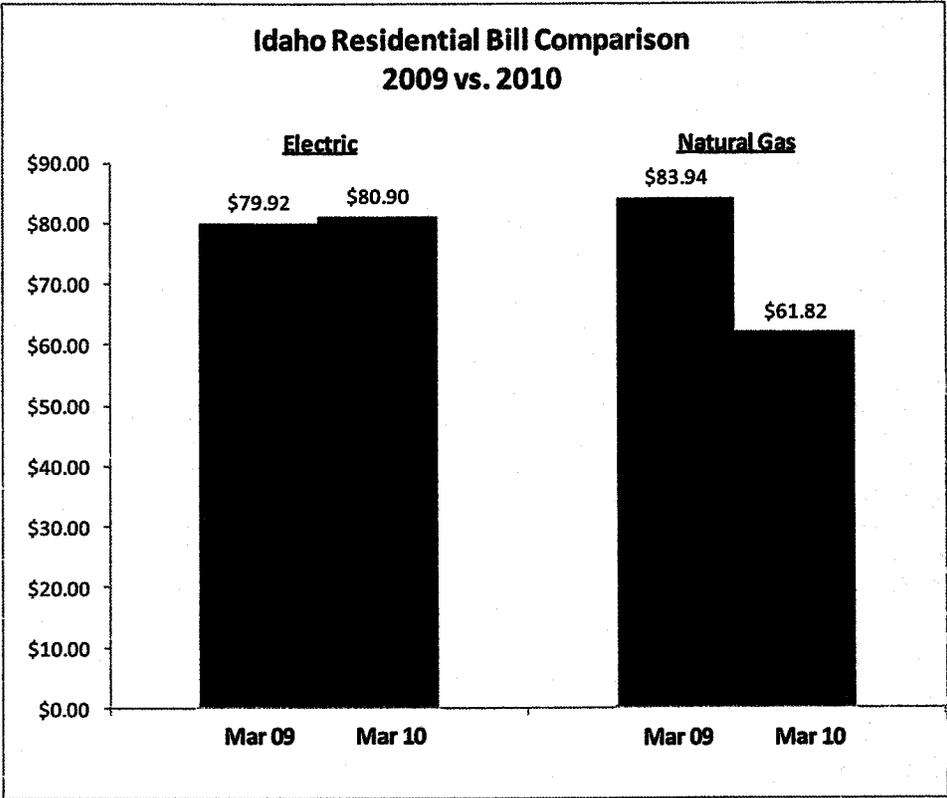
9 In spite of our best efforts to manage our costs, the
10 expiration of low-cost power contracts, the required
11 addition of higher-cost resources to serve increasing loads,
12 the required investment to replace aging infrastructure, and
13 the costs to comply with ever-increasing mandates makes it
14 absolutely necessary to request an increase in our rates.

15 **Q. How do Avista's rates for residential customers**
16 **today compare to what they were a year ago?**

17 A. The following chart shows a comparison of a
18 monthly bill for both an Idaho residential electric and
19 natural gas customer in March 2010 versus March 2009.⁴ The
20 chart shows that the current electric bill is slightly above
21 last year, while the current natural gas bill is 26.4% below
22 last year.

⁴ Using 964 kWh per month for electric, and 63 therms per month for natural gas.

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Although we are pleased that rates have only slightly increased for electric and substantially decreased for natural gas customers in the last year, it is very important that rates be adjusted now to allow the Company the opportunity to recover the increased costs that we are experiencing.

Q. Is the Company currently recovering its costs to provide service to its customers?

A. No. We are currently not recovering our costs to serve customers, and we are not earning the return on investment that this Commission has determined to be fair

1 and reasonable. Although we recently reported improved
2 earnings in 2009 as compared to 2008, the utility return on
3 equity in 2009 was 9.2% which is below our authorized return
4 of 10.5% in Idaho.

5 The current earnings guidance for Avista Utilities for
6 2010 is the range of \$1.45 to \$1.60 per common share. At
7 December 31, 2009 Avista had approximately 55.0 million
8 common shares outstanding, and an equity investment in the
9 utility of \$970 million, per our 2009 10-K filed with the
10 Securities and Exchange Commission. For illustrative
11 purposes only, if we were to assume that Avista's earnings
12 were in the middle of the earnings guidance, at \$1.53/share,
13 it would result in a return on investment for equity holders
14 of 8.7 %. Even if the Company were to achieve the upper end
15 of the range at \$1.60/share, the ROE would be 9.1%, which is
16 still well below the 10.5% authorized by the Commission.

17 In the comments that we receive from our customers, it
18 appears that some of them believe that the utility earnings
19 (profits) that we report are excessive, or are dollars over
20 and above what is needed to run the utility. But this is
21 obviously not the case. The facilities we use to serve
22 customers are financed with both debt, from bondholders and
23 banks, as well as equity investment from shareholders. Both
24 sources of funds are essential to running the utility. Just

1 as debt-holders expect to be paid interest for the use of
2 their funds, shareholders expect a return on their
3 investment in the utility, i.e., the profit or return on
4 equity.

5 Not only is it important that we earn a profit, but as
6 Mr. Thies and Mr. Avera explain in more detail, the profit
7 must be sufficient to attract the equity investor to Avista.
8 Investors have many choices on where to invest their
9 dollars, and we are competing with not only other utilities
10 for equity dollars, but also with businesses in other
11 sectors of the economy.

12 Therefore, it is very important that the rate increase
13 granted in this case provide recovery of our costs to serve
14 customers and the opportunity to earn a fair return for
15 shareholders, so that we can attract equity investment under
16 reasonable terms.

17 **Q. The Avista Board of Directors recently raised the**
18 **quarterly dividend to shareholders from \$0.21 per share to**
19 **\$0.25 per share. Is this dividend change another element of**
20 **attracting equity investment to Avista?**

21 **A. Yes. Dividends paid to shareholders is one of the**
22 **important factors that an investor considers in deciding**
23 **where to invest his or her money, especially in the utility**
24 **industry. The current payout ratio (dividends paid as a**

1 percentage of earnings) for the utility industry is
2 generally in the range of 60% to 70%. Avista's payout ratio
3 has been below this range, and the Board has indicated its
4 intention to raise the dividend payout over time to be
5 within this range. Even with the recent dividend increase,
6 Avista's dividend payout ratio is on the lower end of the
7 60% to 70% range. Again, we are competing with other
8 companies for shareholder investment, and the recent change
9 in the dividend moved us closer to what other utilities are
10 paying out to investors.

11 **Q. Do you have any comments on the Company's access**
12 **to debt capital?**

13 A. Yes. I am concerned that Avista's credit ratings
14 continue to be on the lowest rung of the investment-grade
15 scale: a BBB- on Standard & Poor's scale. If we were to
16 experience adverse conditions that would cause our credit
17 rating to drop one notch, we would be below investment-
18 grade. A drop below investment-grade would make it much
19 more difficult to access capital under reasonable terms.
20 Costs to our customers would be higher due to the payment of
21 higher interest rates. Some counterparties would not sell
22 wholesale electricity or natural gas to us because of our
23 credit standing, and those that would sell to us would
24 require cash up front or some form of collateral. A drop in

1 our credit rating would also affect our access to equity
2 capital. Some institutions are precluded from owning stock
3 in companies that have a credit rating below investment
4 grade, which would put downward pressure on our stock price
5 and access to equity capital.

6 As Mr. Thies explains in his testimony, it is important
7 that we improve our credit metrics so that we can move up a
8 notch from BBB- to BBB. This would give the Company and its
9 customers further protection in the event of an unforeseen,
10 adverse event that may result in a downgrade. When Avista
11 lost its credit rating in 2001, it took approximately six
12 years to get it back. Because it could be very costly for
13 the Company and our customers if we were to drop below
14 investment grade, it is very important that we gain one
15 notch to provide that protection.

16 In order to gain and preserve a BBB credit rating, it
17 is critically important that the Commission's order in this
18 case provide timely recovery of our increased costs to serve
19 customers, so that our credit metrics will be sufficient to
20 support the higher rating.

21 **V. COST MANAGEMENT AND EFFICIENCIES**

22
23 **Q. What is Avista doing to manage its costs and**
24 **mitigate the impact of increased costs on its customers?**

1 A. Although the current economic conditions are at
2 the forefront of everyone's minds, Avista has focused on
3 managing its costs to mitigate rate pressure over a much
4 longer period of time. Following the energy crisis of
5 2000/2001, Avista cut its operating expenses and reduced
6 capital spending. Since that time we have continued to pay
7 particular attention to limiting the growth in these costs,
8 and Avista continues to run its operations with attention to
9 minimizing expenses, while meeting its reliability and
10 environmental compliance requirements, and preserving a high
11 level of customer satisfaction. We worked very hard for
12 many years to gain upgrades to our corporate credit ratings
13 to investment grade by Moodys Investors Service in December
14 2007 and Standard & Poors in February 2008. Part of what
15 made that possible was tight controls on operating expenses
16 and capital investment in recent years.

17 One of the more recent decisions to reduce near-term
18 costs was to delay the construction of the Reardan Wind
19 Project. While there were reasons to build it now, we
20 concluded that the near-term cost impacts to our customers
21 did not outweigh the uncertain long-term benefits of
22 building it now. If we were to build it prior to the end of
23 2012 we could take advantage of a 30% investment tax credit

1 under the Federal Stimulus Package, and also benefit from a
2 Washington state sales tax credit of 7.7% for the Project.

3 On the other hand, as the law (in Washington) stands
4 now, we do not need additional renewable energy credits
5 until 2016, and do not need new energy resources until 2019.
6 And even with the tax credits, the cost of power from the
7 project would be 9 to 10 cents per kWh, which would have
8 resulted in a rate increase for our customers. The cost of
9 the Project would be over \$200 million, which is sizable in
10 relation to our current electric rate base of over \$1.6
11 billion. So even though the Project is "on sale" now
12 because of the available tax credits, we concluded that the
13 Company and our customers simply cannot afford it at this
14 time.

15 **Q. What other measures has the Company taken to**
16 **mitigate increased costs?**

17 A. Avista is constantly looking for improvements in
18 the way it provides services to its customers, as well as
19 ways to reduce the costs of those services. Ideas are
20 generated through periodic evaluation of our operating
21 practices, and communications with other utilities and other
22 industry participants across the country on best practices.

23 Some of the measures we have taken to control costs and
24 improve efficiency are as follows:

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Hiring Restriction

The Company continues to operate under a hiring restriction which requires approval by the Chairman/President/CEO, the CFO, and the Sr. VP for Human Resources for all replacement or new hire positions.

Limitations on Capital Spending

For both 2009 and 2010 Avista approved a lower capital budget than was requested by the Company's Engineering and Operations personnel. The Capital Prioritization Committee reduced the list of projects to be completed by approximately \$60 million in 2009, and we have limited our near-term capital budget to approximately \$210 million annually (excluding Stimulus Projects⁵).

Long Term Debt Issuance

As explained further by Mr. Thies, in 2008 the Company opted to defer its plan to issue \$250 million of long-term secured debt until 2009. Avista instead established a second bank line of credit to ensure continued adequate liquidity. The Company's decision to delay the debt issuance, and rely on short-term debt for a longer period of time, resulted in a reduction of interest costs to customers by approximately \$80 million over a ten year period (approximately \$8 million annually). This benefit to customers is reflected in our filing.

Cancelled Office Building Addition

Avista's main office building was constructed in 1958, and expanded in 1978. Even though Avista's ratio of the number of customers served per employee continues to increase, we have needed additional office space for some time. In 2008, in order to reduce costs, we cancelled plans to build additional office space adjacent to the main office, and instead

⁵ Avista was awarded matching grants from the U.S. Department of Energy for two "Smart Grid" projects. One project will upgrade portions of the utility's electric distribution system to smart grid standards in Spokane, Washington and the other project is a demonstration project in Pullman, Washington that involves automation of many parts of the electric distribution system using advanced metering, enhanced utility communication and other elements of smart grid technologies.

1 chose to remodel existing space formerly used by
2 Horizon Credit Union nine miles from the main office.
3

4 **Outsourced Billing and Disaster Recovery**

5 Avista's bill printing and mail services were
6 outsourced to Regulus, the second largest first class
7 mailer in the United States. The project objectives
8 were to move bill printing, inserting and mailing
9 offsite and to leverage core competencies of the
10 provider. It will also serve to meet disaster
11 recovery requirements, ensure daily print volume
12 flexibility and scalability, reduce costs for bill
13 print, inserting and mailing, and serve to maximize
14 technology.
15

16 **Sale of Renewable Energy to California**

17 Our existing hydroelectric generation does not qualify
18 as renewable energy under the Washington State Energy
19 Independence Act (I-937). However, Avista took the
20 initiative to qualify some of its Spokane River
21 hydroelectric projects as certified renewable resources
22 under California guidelines. Avista is now selling the
23 "green tags" from these projects to California
24 utilities at a premium, and flowing 100% of these
25 benefits through to our retail customers. The
26 additional value included in this rate case for
27 customers from these sales is \$5.4 million on a system
28 basis.
29

30 We recognized that our proposed rate increases will
31 result in energy bills that will be more difficult for some
32 of our customers to pay. I can assure you that we are not
33 just sitting on the sidelines as our costs go up, as
34 evidenced by these measures and others explained by Mr.
35 Kopczynski.

36 **VI. COMMUNICATIONS WITH CUSTOMERS**

37 Q. Is Avista communicating with its customers to
38 explain what is driving increased costs for the Company?

Morris, Di
Avista Corporation

1 listening to our customers' point-of-view and sharing ours
2 about energy issues that directly affect us all.

3 We'll continue focusing on informing our customers of
4 the many programs we offer to provide assistance in managing
5 their energy bills, and ensuring that our employees are
6 equipped to engage in these conversations. We will also work
7 to build understanding on how decisions today, specifically
8 in areas such as energy efficiency, sustainability,
9 reliability and renewable energy will affect our energy
10 future.

11 **VII. CUSTOMER SUPPORT PROGRAMS**

12 **Q. What is Avista doing to assist customers with**
13 **their energy bills?**

14 **A.** We have a history of making it a priority within
15 our Company to maintain meaningful programs to assist our
16 customers that are least able to pay their energy bills. We
17 also have programs to assist our entire customer base, i.e.,
18 not just our low-income customers. Some of the key programs
19 that we offer or support are as follows:

20
21 **1. Increased DSM Programs and Funding.** In January 2009
22 Avista proposed, and the IPUC approved,
23 modifications to the Company's energy efficiency
24 program offerings. The modifications further
25 broadened the technical and financial support Avista
26 provides to its customers, and provides customers
27 with increased opportunity to manage their energy
28 bills. In 2008 Avista also launched the award-

1 winning "Every Little Bit" energy efficiency
2 promotional campaign which integrates all of the
3 Company's energy efficiency programs into one
4 location.
5

6 **2. Project Share.** Project Share is a voluntary
7 program allowing customers to donate funds that are
8 distributed through community action agencies to
9 customers in need. In addition to the customer and
10 employee contributions in 2009 of \$81,700 in Idaho,
11 the Company contributed \$111,800, Idaho's share, to
12 the program in 2009.
13

14 **3. Comfort Level Billing.** The Company offers the
15 option for all customers to pay the same bill
16 amount each month of the year by averaging their
17 annual usage. Under this program, customers can
18 avoid unpredictable winter heating bills.
19

20 **4. CARES Program.** Customer Assistance Referral and
21 Evaluation Services provides assistance to special-
22 needs customers through access to specially trained
23 (CARES) representatives who provide referrals to
24 area agencies and churches for help with housing,
25 utilities, medical assistance, etc.
26

27 Again, Mr. Kopczynski provides additional detail in
28 his testimony concerning these and other programs designed
29 to assist customers.

30 **Q. Are there other programs in the State of Idaho**
31 **that are available to provide assistance to customers that**
32 **need help with their energy bill?**

33 **A. Yes.** On September 30, 2008, President Bush signed
34 legislation that provided \$5.1 billion for the Low Income
35 Home Energy Assistance Program (LIHEAP) for the 2008/2009
36 heating season. This increased funding was to serve an
37 additional 2 million households and raise the average grant

1 from \$355 to \$550 and also allow states to carryover any
2 funds remaining to the next years heating season. Idaho's
3 share of the LIHEAP funding was increased from \$12,376,000
4 to \$26,940,000.

5 On December 16, 2009, President Obama signed an omnibus
6 appropriations bill that continued to provide \$5.1 billion
7 in funding for the Low Income Home Energy Assistance program
8 for the current fiscal year. The LIHEAP funding includes
9 \$4.5 billion in formula funds and \$590 million in
10 contingency funding. Idaho's share of the LIHEAP funding was
11 increased from \$26,940,000 to \$28,094,000. This bill also
12 provides increased funding for weatherization assistance
13 programs. These programs and the partnerships we have formed
14 have been invaluable to customers who often have nowhere
15 else to go for help.

16 **Q. Has the Company conducted any research to assess**
17 **the effect of the level of support provided by the low**
18 **income assistance programs offered by Avista?**

19 A. Yes. In 2009, Avista commissioned a study by the
20 Institute for Public Policy and Economic Analysis through
21 Eastern Washington University. The purpose of the study was
22 "Assessing Heating Assistance Programs in Spokane County."⁶

⁶ "Assessing Heating Assistance Programs in Spokane County", Institute for Public Policy & Economic Analysis (Grant Forsyth, PhD, D. Patrick Jones, PhD, and Mark Wagner). January 2010.

1 As noted in that report, the study examined "the recent
2 experience of the two largest heating assistance programs in
3 Spokane County: the federal Low Income Home Energy
4 Assistance Program (LIHEAP) and the Avista Utilities-funded
5 Low Income Rate Assistance Program (LIRAP). The study's
6 central goal was to assess the reach of these programs among
7 the eligible population."⁷ The study found, among other
8 things, that the assistance provided to limited income
9 customers by Spokane Neighborhood Action Programs (SNAP),
10 primarily through LIHEAP and LIRAP funds, reduces the
11 "energy burden" for those customers to a level comparable to
12 the average household in Spokane County.

13 Mr. Kopczynski will address the results of this study
14 in more detail in his direct testimony.

15 **Q. Would you please comment on the employees'**
16 **dedication to achieving customer satisfaction?**

17 A. Yes. I am pleased with the dedication of Avista
18 Utilities' employees and their commitment to provide quality
19 service to our customers. While we continue to maintain
20 tight controls on capital and O&M budgets, our customer
21 service surveys indicate that customer satisfaction remains
22 high. Our recent fourth quarter 2009 customer survey
23 results show an overall customer satisfaction rating of 94%

⁷ id., Page 1

1 in our Idaho, Washington, and Oregon operating divisions.
2 This rating reflects a positive experience for the majority
3 of customers who have contacted Avista related to the
4 customer service they received. These results can be
5 achieved only with very committed and competent employees.

6 **VIII. OTHER COMPANY WITNESSES**

7 Q. Would you please provide a brief summary of the
8 testimony of the other witnesses representing Avista in this
9 proceeding?

10 A. Yes. The following additional witnesses are
11 presenting direct testimony on behalf of Avista:

12 Mr. Mark Thies, Senior Vice President and Chief
13 Financial Officer will describe, among other things, the
14 overall financial condition of the Company, its current
15 credit ratings, the Company's plan for improving its
16 financial health, its near term capital requirements, the
17 proposed capital structure, and the overall rate of return
18 proposed by the Company. Mr. Thies explains that:

19 • Avista's plans call for significant capital
20 expenditure requirements for the utility over
21 the next two years to assure reliability in
22 serving our customers and meeting customer
23 growth. Capital expenditures of approximately
24 \$420 million (excluding Stimulus Projects) are
25 planned for 2010-2011 for customer growth,
26 investment in generation upgrades, transmission
27 and distribution facilities for the electric
28 utility business as well as necessary

1 maintenance and replacements of our natural gas
2 utility systems. Capital expenditures of
3 approximately \$1.2 billion are planned for the
4 five year period ending December 31, 2014.
5 Avista needs adequate cash flow from operations
6 to fund these requirements, together with access
7 to capital from external sources under
8 reasonable terms.
9

- 10 • Avista's corporate credit rating from Standard &
11 Poor's (S&P) is currently BBB- and Baa3 from
12 Moody's Investors Service (Moody's). Avista
13 Utilities must operate at a level that will
14 support a strong investment grade corporate
15 credit rating, meaning "BBB" or "BBB+", in order
16 to access capital markets at reasonable rates,
17 which will decrease long-term borrowing costs to
18 customers. Avista has been placed on "positive"
19 outlook by both S&P and Moody's, which may
20 result in an upgrade as early as August 2010.
21 The regulatory environment will be taken into
22 consideration by the rating agencies when
23 reviewing Avista for a possible upgrade.
24 Maintaining solid credit metrics and credit
25 ratings will also help support a stock price
26 necessary to issue equity to fund capital
27 requirements.
28

- 29 • The Company has proposed an overall rate of
30 return of 8.55%, including a 50% equity ratio
31 and a 10.9% return on equity. Our cost of debt
32 is 6.2%. We believe the 10.9% proposed ROE
33 provides a reasonable balance of the competing
34 objectives of continuing to improve our
35 financial health, and the impacts that increased
36 rates have on our customers.
37

38
39
40 Dr. William E. Avera, as a President of Financial
41 Concepts and Applications (FINCAP), Inc., has been retained

1 to present testimony with respect to the Company's cost of
2 common equity. He concludes that:

- 3 • In order to reflect the risks and prospects
4 associated with Avista's jurisdictional utility
5 operations, his analyses focused on a proxy group
6 of seventeen other utilities with comparable
7 investment risks. Consistent with the fact that
8 utilities must compete for capital with firms
9 outside their own industry, he also references a
10 proxy group of comparable risk companies in the
11 non-utility sector of the economy;
- 12 • Based on his evaluation of the strength of the
13 various methods, Dr. Avera concluded that the cost
14 of equity for the proxy groups of utilities and
15 non-utility companies is in the **10.9 percent to**
16 **12.5 percent** range, or **11.1 percent to 12.7 percent**
17 after incorporating an adjustment to account for
18 the impact of common equity flotation costs;
- 19 • Because Avista's requested ROE of 10.9 percent falls
20 at the very bottom of his "bare bones" cost of
21 equity range, it represents a conservative estimate
22 of investors' required rate of return.

23
24 Mr. Richard Storro, Vice President of Energy Resources,
25 will provide an overview of Avista's resource planning and
26 power supply operations. This includes summaries of the
27 Company's generation resources, the current and future load
28 and resource position, future resource plans, and an update
29 on the Company's plans regarding the acquisition of new
30 renewable resources. He will also address hydroelectric and
31 thermal project upgrades, followed by an update on recent
32 developments regarding hydro licensing.

1 Mr. Clint Kalich, Manager of Resource Planning & Power
2 Supply Analyses, will describe the Company's AURORA_{XMP} model
3 (Dispatch Model) inputs, assumptions, and results related to
4 the economic dispatch of Avista's resources to serve load
5 requirements, and market forecast of electricity prices. He
6 explains:

- 7 • The key assumptions driving the Dispatch Model's
8 market forecast of electricity prices. This
9 discussion includes the variables of natural gas,
10 Western Interconnect loads and resources, and
11 hydroelectric conditions.
- 12 • How the Model dispatches Avista's resources and
13 contracts in a manner that maximizes benefits to
14 customers.
- 15 • The output results from the Model, including
16 thermal generation and short-term wholesale sales
17 and purchases, were provided to Mr. Johnson to
18 incorporate into the power supply pro forma
19 adjustments.
20

21 Mr. William Johnson, Wholesale Marketing Manager, will
22 identify and explain the proposed normalizing and pro forma
23 adjustments to the test period power supply revenues and
24 expenses. He will also explain the new base level of power
25 supply costs for Power Cost Adjustment (PCA) calculation
26 purposes using the pro forma costs proposed by the Company
27 in this filing. Mr. Johnson describes:

- 28 • The proposed normalizing and pro forma adjustments
29 to the January 2009 through December 2009 test
30 period power supply revenues and expenses
- 31 • Describe the proposed level of authorized expense
32 and retail revenue credit for the Power Cost

1 Adjustment (PCA) calculation purposes, using the
2 pro forma costs proposed by the Company in this
3 filing.
4

5 Mr. Don Kopczynski, Vice President of Transmission and
6 Distribution Operations, will describe Avista's electric and
7 natural gas energy delivery facilities and operations, and
8 recent efforts to increase efficiency and improve customer
9 service. Mr. Kopczynski describes:

- 10 • Avista's customer service programs such as the
11 energy efficiency, Project Share, CARES program,
12 Senior Outreach Program, and payment plans. Some
13 of these programs will serve to mitigate the
14 impact on customers of the proposed rate increase.
- 15 • The Company's multi-faceted effort to increase
16 customer service automation, including replacement
17 and upgrade of the new Enterprise Voice Portal
18 (EVP) system.

19
20 Mr. Scott Kinney, Director, Transmission Operations,
21 will discuss the electric transmission and distribution
22 capital investments included in this case, and presents the
23 Company's pro forma period transmission revenues and
24 expenses.

25 Mr. Dave DeFelice, Senior Business Analyst, will
26 describe the Company's proposed pro forma adjustments for
27 capital investments in utility plant for the 2009 test
28 period. Mr. DeFelice explains:

- 29 • The rising cost of essential materials specific to
30 the utility industry is causing significant
31 increases in capital project funding requirements.

- 1 • Pro forma operating results including expense and
2 rate base adjustments.
3 • System and jurisdictional allocations.
4

5 Ms. Tara Knox, Senior Regulatory Analyst, sponsors the
6 cost of service studies for electric and natural gas
7 service, the revenue normalization adjustments to results of
8 operations, the results from the Company's demand study, and
9 the proposed retail revenue credit rate. Ms. Knox's studies
10 indicate:

- 11 • Electric residential service, extra large
12 general service, and pumping service schedules
13 are earning less than the overall rate of return
14 under present rates, while general service,
15 large general service and the street and area
16 lighting service schedules are earning more than
17 the overall rate of return under present rates.
18 • Natural Gas residential service schedule is
19 earning less than the overall rate of return at
20 present rates, and all other service schedules
21 are earning more than the overall rate of
22 return.
23

24 Mr. Patrick Ehrbar, Manager of Rates and Tariffs,
25 discusses the spread of the proposed annual revenue changes
26 among the Company's general service schedules. He explains,
27 among other things, that:

- 28 • The proposed increase in electric base rates is
29 14.0%, which consists of an increase in electric
30 base retail rates of \$32.1 million.
31 • The monthly bill for a residential customer using
32 an average of 964 kWhs per month would increase
33 from \$77.95 to \$89.35 per month, an increase of

1 \$11.40 or 14.6%. This includes the proposed
2 increase in the monthly basic or customer charge
3 from \$4.00 to \$6.75.

- 4 • The proposed natural gas annual revenue increase
5 in base rates is \$2.6 million, or 3.6%.
- 6 • The monthly bill for a residential customer using
7 63 therms per month would increase from \$56.03 to
8 \$58.80 per month, an increase of \$2.77 or 4.9 %.
9 This includes the proposed increase in the monthly
10 basic or customer charge from \$4.00 to \$6.75.

11
12 Mr. Bruce Folsom, Senior Manager of Demand Side
13 Management, provides an overview of the Company's DSM
14 programs and documents Avista's expenditures for electric
15 and natural gas energy efficiency programs. Mr. Folsom
16 explains that:

- 17 • The Company continues to exceed the targets
18 established as part of the IRP process. Electric
19 efficiency savings for 2009 were 141% of the
20 annual target and natural gas therms saved for
21 2009 were 128% of the annual target.
- 22 • Avista's expenditures for electric and natural gas
23 energy efficiency programs from January 1, 2008
24 through December 31, 2009 have been prudently
25 incurred.

26
27 **Q. Does this conclude your pre-filed direct**
28 **testimony?**

29 A. Yes.

30

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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

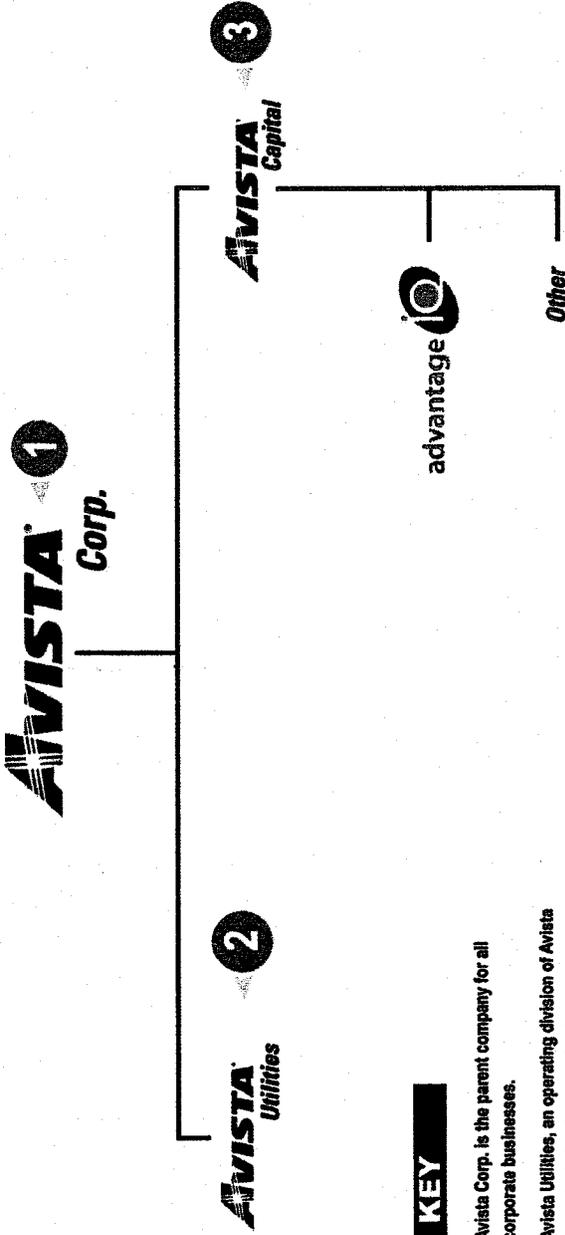
IN THE MATTER OF THE APPLICATION) CASE NO. AVU-E-10-01
OF AVISTA CORPORATION FOR THE) CASE NO. AVU-G-10-01
AUTHORITY TO INCREASE ITS RATES)
AND CHARGES FOR ELECTRIC AND)
NATURAL GAS SERVICE TO ELECTRIC) EXHIBIT NO. 1
AND NATURAL GAS CUSTOMERS IN THE)
STATE OF IDAHO) SCOTT L. MORRIS
_____)

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

Avista Corporation Overview

Avista Corporate Business Organizational Structure



KEY

- ① Avista Corp. is the parent company for all corporate businesses.
- ② Avista Utilities, an operating division of Avista Corp., includes the regulated businesses, serving customers in Washington, Idaho and Oregon.
- ③ Avista Capital is the parent company of all non-regulated subsidiaries. Avista Capital is a wholly owned subsidiary of Avista Corp.

