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**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

IN THE MATTER OF THE APPLICATION	)	CASE NO. AVU-E-04-01
OF AVISTA CORPORATION FOR THE	)	CASE NO. AVU-G-04-01
AUTHORITY TO INCREASE ITS RATES	)	
AND CHARGES FOR ELECTRIC AND	)	
NATURAL GAS SERVICE TO ELECTRIC AND	)	DIRECT TESTIMONY
NATURAL GAS CUSTOMERS IN THE STATE	)	OF
OF IDAHO	)	SCOTT L. MORRIS
_____	)	

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

1 **I. INTRODUCTION**

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

3 A. My name is Scott L. Morris and I am employed as the President of Avista  
4 Utilities and Senior Vice-President of Avista Corporation, at 1411 East Mission Avenue,  
5 Spokane, Washington.

6 **Q. Would you briefly describe your educational background and professional  
7 experience?**

8 A. I am a graduate of Gonzaga University with a Bachelors degree and a Master's  
9 degree in organizational leadership. I have also attended the Kidder Peabody School of  
10 Financial Management.

11 I joined the Company in 1981 and have served in a number of roles including customer  
12 service manager. In 1991, I was appointed general manager for Avista Utilities' Oregon and  
13 California natural gas utility business. I was appointed President and General Manager of  
14 Avista Utilities, an operating division of Avista Corporation, in August 2000. In February  
15 2003, I was appointed Senior Vice-President of Avista Corporation.

16 In 1999, I was appointed by then-Governor John Kitzhaber as a board member of the  
17 Oregon Economic and Community Development Commission. I served as a member of the  
18 board of directors and as board president of Southern Oregon Regional Economic  
19 Development Inc. I served as a director and board president of the Medford/Jackson County  
20 Chamber of Commerce, and board member and board president of the Providence Community  
21 Health Foundation.

1 I am currently a member of the Providence Services of Eastern Washington board of  
2 directors, a member of the Gonzaga University board of regents, a director of the Washington  
3 Roundtable, and Chairman of the Spokane Regional Chamber of Commerce board of trustees.  
4 In 2002, I was appointed by Governor Locke to the Chairmanship of the Washington Economic  
5 Development Commission.

6 **Q. What is the scope of your testimony?**

7 A. I am testifying as the policy witness for the Company. I provide an overview of  
8 Avista Corporation and Avista Utilities. I describe Avista Utilities' overall utility operations,  
9 the Company's rate request in this filing, and the major factors driving the Company's need for  
10 general rate relief. I will also explain the Company's customer support programs that are in  
11 place to assist our customers. In addition, I will briefly discuss some of the current and future  
12 challenges that are being addressed by the Company. Thereafter, I introduce each of the other  
13 witnesses providing testimony on the Company's behalf.

14 **Q. Are you sponsoring an exhibit in this proceeding?**

15 A. Yes. I am sponsoring Exhibit No. 1, which was prepared under my direction.

16  
17 **II. OVERVIEW OF AVISTA**

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

19 A. Avista Utilities provides electric and natural gas service within a 26,000  
20 square mile area of northern Idaho and eastern Washington. The Company, headquartered in  
21 Spokane, Washington, also provides natural gas distribution service in southwestern and  
22 northeastern Oregon, and in the South Lake Tahoe area of California. Maps showing the

1 Company's electric and natural gas Idaho service area and Avista's total natural gas and  
2 electric service areas are provided in pages 1, 2, and 3 of Exhibit No. 1.

3 As of December 31, 2003, Avista Utilities had total assets of approximately \$2.4  
4 billion (on a system basis), with electric retail revenues of \$490 million (system) and natural  
5 gas retail revenues of \$277 million (system). As of December 2003, the Utility had 1,450  
6 full-time employees.

7 **Q. Please describe Avista Utilities' Idaho electric and natural gas utility**  
8 **operations.**

9 A. Of the Company's 325,645 electric and 298,411 natural gas customers (at year  
10 end 2003), 109,315 and 61,799, respectively, were Idaho customers. The Company serves  
11 the Idaho counties of Benewah, Bonner, Boundary, Clearwater, Idaho, Kootenai, Latah,  
12 Lewis, Nez Perce, and Shoshone. Lumber and wood products manufacturing is the dominant  
13 industry in our Idaho service area. Approximately 32% of 2003 Idaho electric retail usage  
14 was from residential customers, with 29% from commercial, 38% from industrial customers,  
15 and 1% from pumping customers. Approximately 72% of natural gas retail revenues were  
16 from residential customers, and 18% from commercial and 10% from industrial and  
17 transportation customers. The Company has seven transportation customers in Idaho.  
18 Additional details of usage by customer class are shown on page 4 of Exhibit No. 1.

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

21 A. The Company has worked hard to continue to operate what I believe to be a  
22 very efficient utility. Over the past three years the Company has faced a number of serious

1 challenges and has instituted several aggressive measures to manage its way through the  
2 financial difficulties presented by the record-low hydro conditions, unprecedented high  
3 wholesale market prices and power plant construction expenditures. Some of these measures  
4 include the sale of 50% of the Coyote Springs 2 project, divestiture of Avista Communications  
5 and a majority share of Avista Labs, and significant temporary reductions in capital and  
6 operation and maintenance (O&M) budgets, intended to get the Company through this difficult  
7 period. Mr. Malquist will discuss further the actions taken by the Company to improve cash  
8 flow, reduce debt, and work toward regaining an investment grade credit rating.

9 Our strategy continues to focus Avista Corp. activities on our energy and energy-  
10 related businesses, with our primary focus on the electric and natural gas utility business.  
11 There are four distinct components to our business focus for the utility, which we have  
12 referred to as the four legs of a stool, with each leg representing customers, employees, the  
13 communities we serve, and our financial investors. For the stool to be level, each of these legs  
14 must be in balance by having the proper focus. This means we must maintain a strong, low-  
15 cost utility business by delivering efficient, reliable and high quality service to our customers  
16 and the communities we serve. We are fortunate to have dedicated employees who, despite  
17 the past three years of reduced budgets due to turbulence in the industry, have maintained high  
18 morale and high customer satisfaction.

19 For our subsidiaries, specifically our non-regulated energy activities, we are managing  
20 the size and the risk associated with this business, which we have done by scaling back  
21 operations to the Western Electricity Coordinating Council (WECC) region, to make the best  
22 use of our knowledge and experience in markets we know well.

1           **Q.     Please briefly describe Avista’s subsidiary businesses.**

2           A.     Avista Corp.’s subsidiaries, headquartered in Spokane, Washington, include the  
3 energy marketing and resource management business, Avista Energy, and the information and  
4 technology business, Avista Advantage, described below. In 2001, Avista disposed of  
5 substantially all of the assets of Avista Communications, and sold eighty-three percent of  
6 Avista Labs in 2003. A diagram of Avista’s corporate structure is provided on page 5 of  
7 Exhibit No. 1.

8           Avista Energy is our energy marketing and resource management business, operating  
9 primarily within the WECC. Besides the Spokane headquarters, Avista Energy also has an  
10 office in Vancouver, British Columbia, Canada. Avista Energy focuses on asset-backed  
11 optimization of combustion turbines and hydroelectric assets owned by other entities, long-  
12 term electric supply contracts, natural gas storage, and electric and natural gas transmission  
13 and transportation arrangements. Avista Energy manages Avista Power’s 49 percent  
14 ownership of a 270 MW natural gas combined cycle combustion turbine plant in Rathdrum,  
15 Idaho, which commenced commercial operation in September 2001. Avista Power is inactive  
16 at this time with no plans for additional generation projects.

17           Avista Advantage is a provider of internet-based facility intelligence, cost  
18 management, billing and information services to multi-site retail customers throughout North  
19 America. Avista Advantage’s solutions are designed to provide multi-site companies with  
20 critical and easy-to-access information that enables them to proactively manage and reduce  
21 their facility-related expenses.

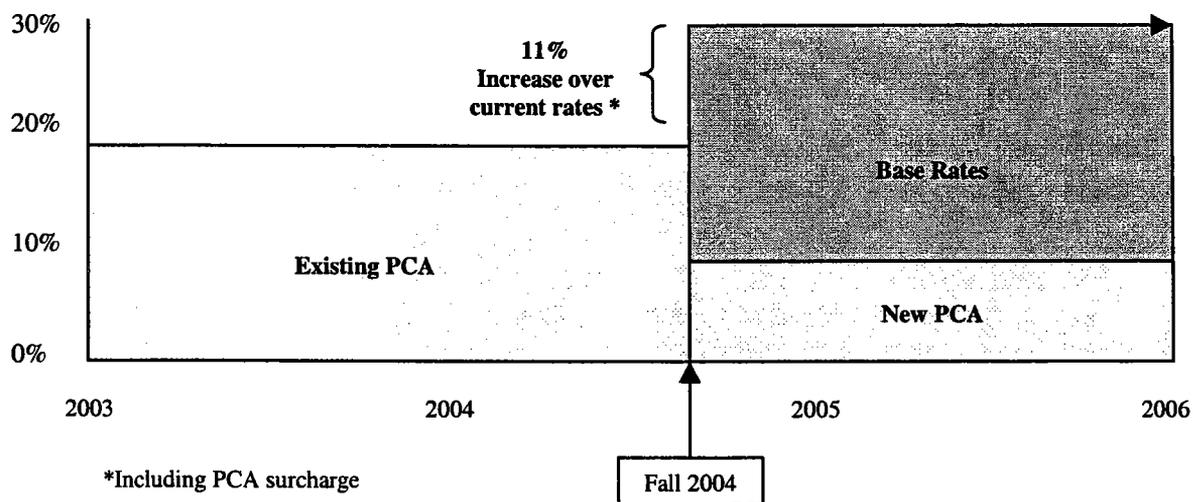
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1 **III. RATE REQUESTS**

2 **Q. Please provide an overview of Avista’s electric rate request in this filing.**

3 A. Through this filing the Company is requesting that the Commission grant a net  
4 electric rate increase of \$18.9 million or 11.0%. I refer to a “net” increase of 11.0%, because  
5 the Company’s overall request for electric operations includes a \$35.2 million or 24.1%  
6 increase in base retail rates. As Mr. Hirschhorn explains in his testimony, in order to mitigate  
7 the overall price increase request in this case, the Company is proposing to reduce the current  
8 Power Cost Adjustment (PCA) surcharge, and recover the remaining PCA balance over a two-  
9 year period. Due to the proposed reduction in the PCA rate, the net overall change to  
10 customers’ electric rates would be 11.0% instead of 24.1%, as illustrated below.

11 **Illustration 1**  
12 **Rate Adjustments**



22 The Company’s request is based on a proposed rate of return of 9.82% with a common  
23 equity ratio of 44.3% and an 11.5% return on equity. The Company is proposing to spread the

1 requested electric increase on a uniform cents per kilowatt hour basis, with an adjustment to  
2 move customer class rates of return one-half way to unity. The illustration below shows the  
3 proposed overall net increase to customer rates, which reflects the proposed reduction in the  
4 PCA surcharge rate.

5  
6 **Illustration 2**

7 <u>Service Schedule</u>	8 <u>Proposed Net Increase</u>
9 Residential Service Schedule 1	13.5%
10 General Service Schedules 11 & 12	8.7%
11 Large General Service Schedules 21 & 22	10.1%
12 Extra Large General Service Schedule 25	15.0%
13 Potlatch (Lewiston) Schedule 25	7.1%
14 Pumping Service Schedules 31 & 32	12.1%
15 Street & Area Lighting Schedules 41-49	<u>12.8%</u>
16 Overall Increase	11.0%

17  
18  
19 The Company is proposing to raise the residential basic charge to \$5.00 from the  
20 current \$4.00 charge. Mr. Hirschorn will provide additional details related to rate spread and  
21 rate design issues.

22 **Q. What is Avista's natural gas rate request in this filing?**

23 A. With regard to natural gas, the Company is requesting an increase of \$4,754,000  
24 or 9.2%. Avista's last general rate increase for natural gas service was approximately fourteen  
25 years ago in 1990. As with the electric increase, the Company's request is based on a proposed  
26 rate of return of 9.82% with a common equity ratio of 44.3% and an 11.5% return on equity.  
27 The Company is proposing to spread the requested natural gas increase on a uniform cents per  
28 therm basis, with an adjustment to move customer class rates of return one-half way to unity.

1 As a result, the proposed rate spread for natural gas would result in an increase for each  
2 customer class as shown in the illustration below.

3  
4 **Illustration 3**

5 <u>Service Schedule</u>	6 <u>Proposed Increase</u>
7 General Service Schedule 101	10.0%
8 Large General Service Schedule 111/112	6.6%
9 High Annual Load Factor – Lg. General Service Schedule 121/122	3.8%
10 Interruptible Sales Service Schedule 131/132	3.4%
11 Transportation Service Schedule 146 (excluding gas costs)	<u>18.2%</u>
12 Overall Increase	9.2%

13  
14 The Company is proposing to raise the residential basic charge to \$5.00 from the  
15 current \$3.28. Mr. Hirschorn will address these rate spread and rate design issues.

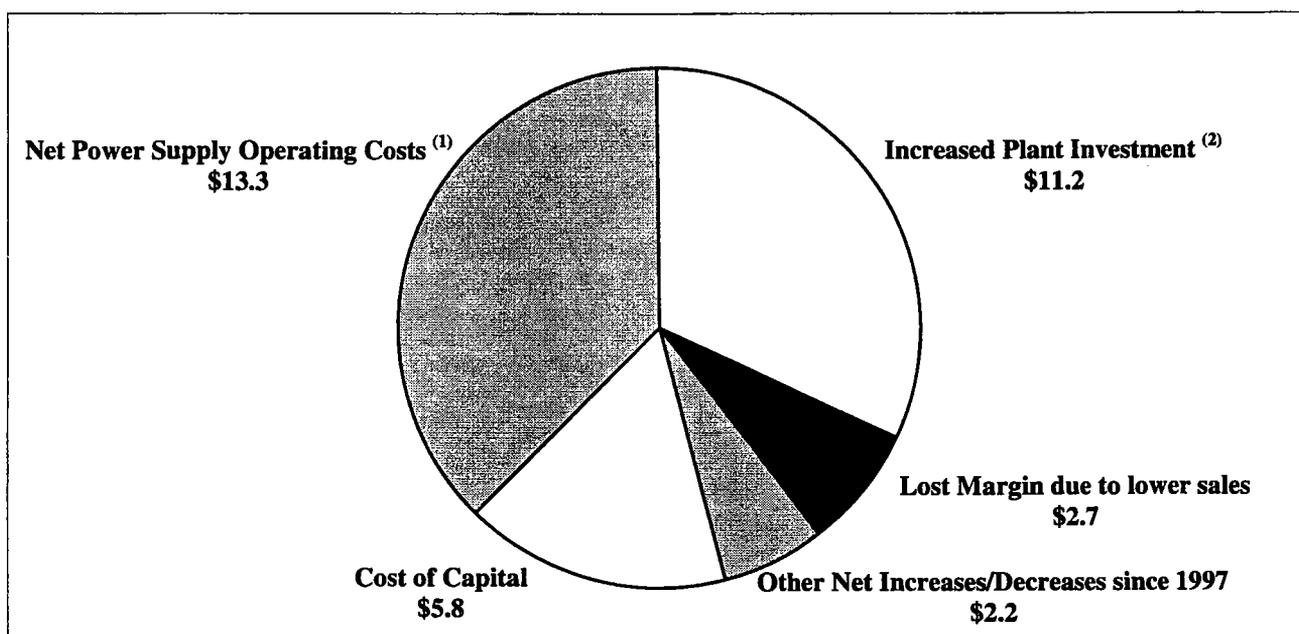
16 **Q. What are the primary factors causing the Company's request for an**  
17 **electric rate increase in this filing?**

18 A. The Company's last electric general rate case in Idaho was filed in 1998 with  
19 rates effective in 1999. Since that time the Company has placed into operation new generating  
20 projects, such as Coyote Springs 2 and Boulder Park. The Company is a 50% owner of the  
21 new Coyote Springs 2, 280-megawatt combined cycle combustion turbine project in Oregon  
22 which commenced commercial operation in July 2003. Boulder Park is a generating project  
23 that includes six natural gas fired reciprocating engines with a total capability of 25 MW.

24 Other factors driving the need for electric rate relief include a reduction in wholesale  
25 sales revenue, and increased fuel costs for thermal generation, primarily natural gas. Mr.  
26 Falkner testifies to these costs and other factors impacting the revenue requirement. In  
27 addition, during the "energy crisis" of 2000 and 2001, it was necessary for Avista to fund high

1 energy costs for both the electric and natural gas business at relatively high borrowing costs.  
2 This resulted in an increase in interest expense, as will be explained in more detail by Mr.  
3 Malquist. The primary factors driving the electric rate request are illustrated below.

4  
5 **Illustration 4**  
6 **Primary Factors Driving \$35.2 Million Electric Case**  
7 **(Dollars in Millions)**



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15 (1) Reduced wholesale revenues (PGE Capacity Sale), and increased fuel costs (Coyote).  
16 (2) Including new investment such as Coyote and Boulder.

17  
18 **Q. What are the primary factors driving the Company's request for a natural**  
19 **gas rate increase?**

20 **A.** Although there are a number of increases and decreases in revenue, expense and  
21 rate base items, for the natural gas business, there are a few major components that drive the  
22 requested rate increase. One of these components is declining therm usage by our customers

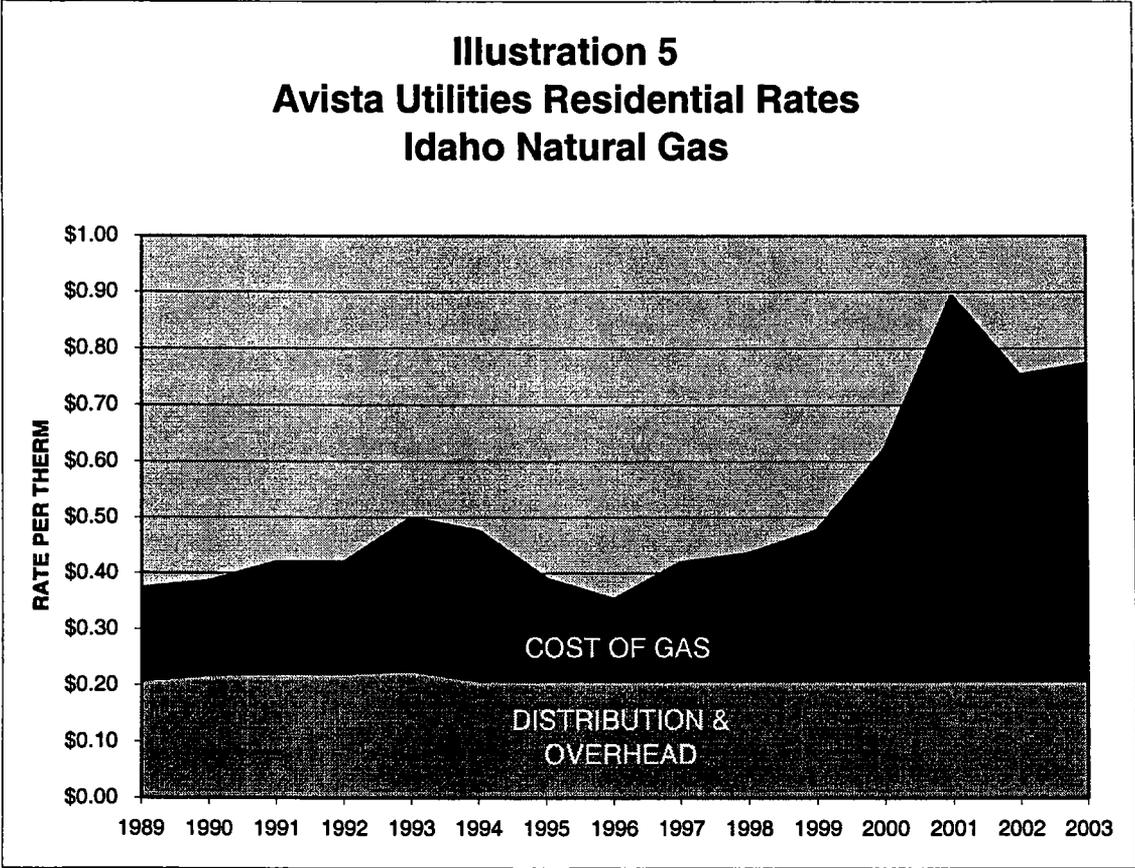
1 on a weather adjusted basis. Residential average usage has decreased from 82 therms per  
2 month in 1999 to 73 therms in 2002, a reduction of about 11%. If residential customers had  
3 averaged 82 therms per month in 2002, the Company's natural gas revenue requirement would  
4 be approximately \$1.3 million less.

5 A second component is an increase in general business expenses since general rates  
6 were last increased in 1990. The number of natural gas customers served by Avista in Idaho  
7 has increased from 23,400 in 1990 to 59,800 in 2002. The decline in natural gas usage by  
8 customers combined with the growth in customers, and the general increase in expenses over  
9 the past fourteen years, has caused the need for rate relief.

10 **Q. You have discussed the base or fixed costs of Avista's natural gas business.**  
11 **There have been significant increases in natural gas commodity costs. Would you please**  
12 **describe these changes?**

13 A. Yes. The natural gas industry has experienced significant volatility and upward  
14 price pressure on wholesale, or commodity, costs of gas. These costs are passed on to  
15 customers through the periodic Purchased Gas Adjustments (PGAs). The following graph  
16 shows the history of commodity cost changes. In addition, the bottom portion of the graph  
17 shows the change in the Company's distribution and overhead costs (base rate costs) over time.  
18 As shown in the illustration, the Company's management of its costs has resulted in these costs  
19 remaining very flat over time, as measured on a per-therm basis.

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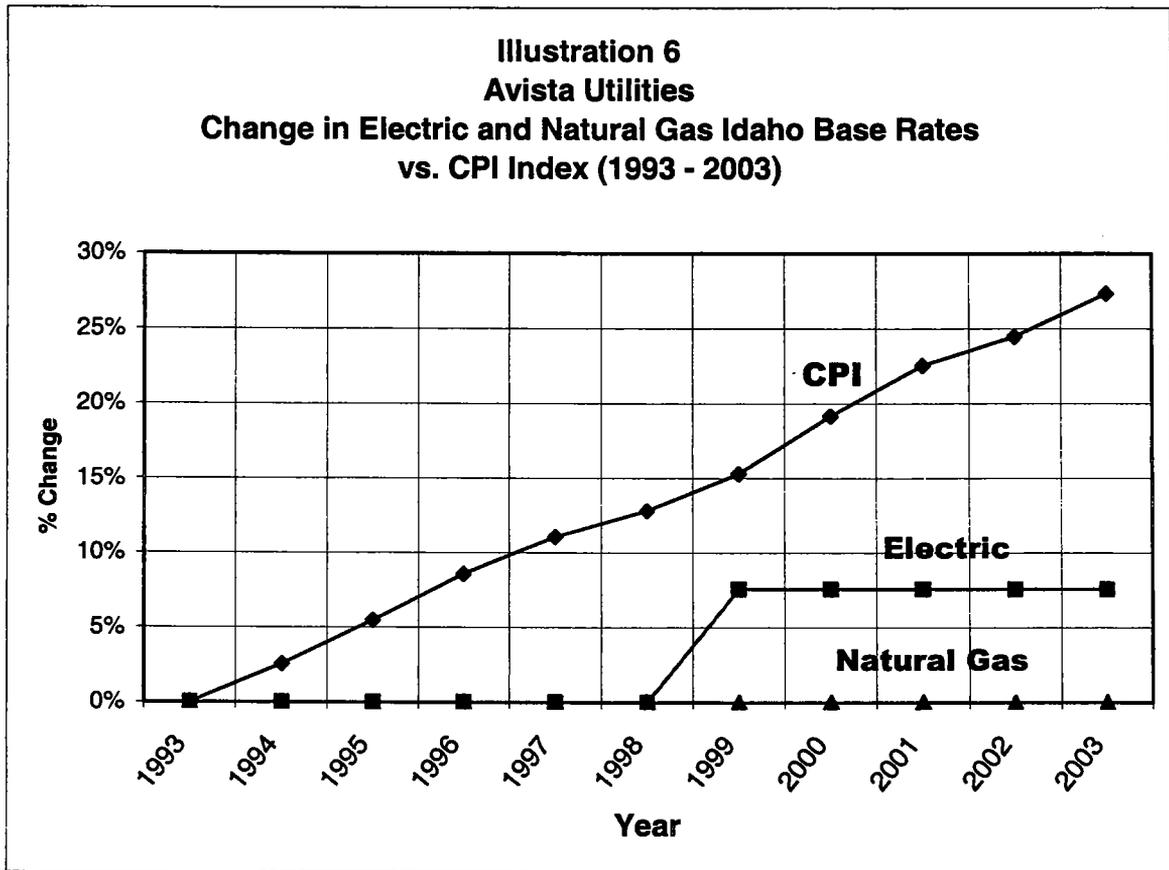
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**Q Has the Company considered the possible economic impacts of the Company's rate proposals in its service territory?**

A. Yes. Through my involvement with area chambers and economic development agencies, I am particularly mindful of the impact that rate increases have on our customers, including the businesses within our service area and the important role the utility plays in the communities we serve. In the long run, a financially healthy utility providing safe and reliable service at competitive rates will foster satisfied customers and healthy communities.

I believe our track record in the past decade demonstrates our commitment to providing excellent service to our customers at the lowest possible cost. This would be the

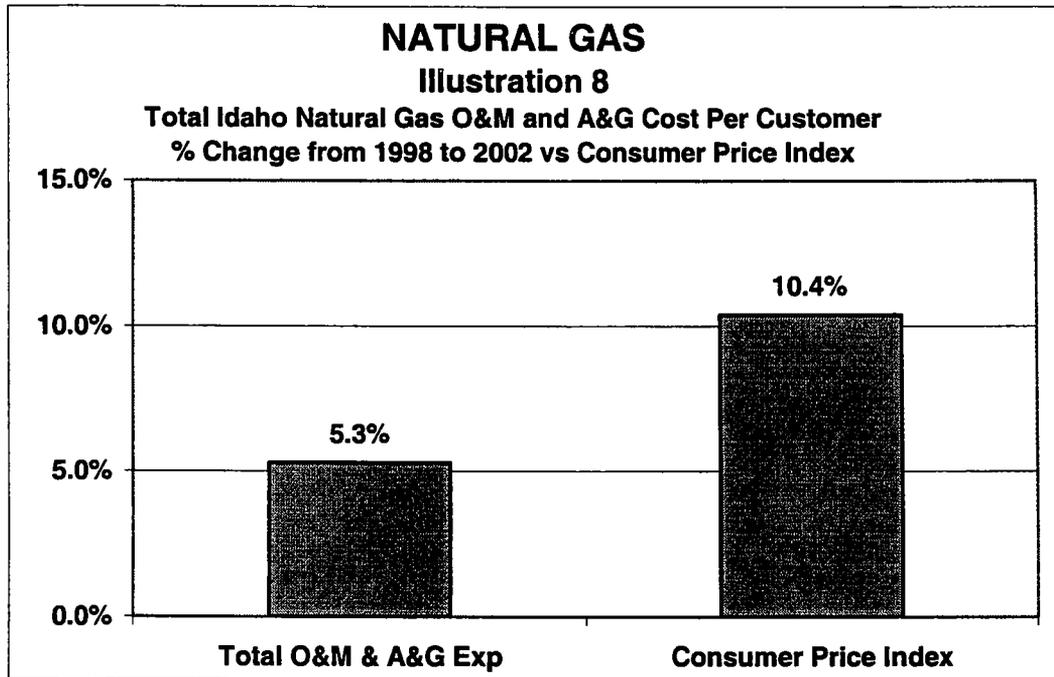
1 second electric general or base rate increase in the last ten years and the first natural gas base  
2 rate increase over the same period. The total increase in electric and natural gas base rates  
3 over the last ten years has been 7.58% for electric and 0% for natural gas, as compared to the  
4 increase in the Consumer Price Index of 27.34% over the same period. This comparison is  
5 shown below.



19 Further, we have attempted to mitigate the impact on customers' electric rates with  
20 the proposal to reduce the PCA surcharge to produce a net average change in current  
21 customer bills of 11.0% rather than an overall increase of 24.1%.

22 **Q. Please describe how Avista Utilities has managed its operating costs.**





11 As the charts illustrate, the Company has managed its Idaho electric and natural gas  
 12 O&M and A&G costs per customer well below the change in the Consumer Price Index. Mr.  
 13 Falkner provides additional testimony related to these changes in costs.

14

15 **IV. CUSTOMER SUPPORT PROGRAMS**

16 **Q. Please outline the programs the Company has in place to mitigate the**  
 17 **impacts on customers of the proposed rate increase.**

18 **A. Avista Utilities offers a number of programs to assist customers who have**  
 19 **difficulty in paying their energy bills. Some of these programs are operated in cooperation**  
 20 **with local Idaho community action agencies who are experienced in targeting the assistance**  
 21 **where it is needed most. These programs include energy efficiency programs, Project Share**  
 22 **for emergency assistance to customers, a CARES programs, level pay plans, and payment**

1 arrangements. These programs are briefly described below. Mr. Kopczynski, a later witness,  
2 provides additional details related to these programs in his testimony.

- 3 • Energy efficiency programs. Avista Utilities offers energy efficiency services  
4 to electric and natural gas residential, commercial, and industrial customers.  
5
- 6 • Project Share. Project Share is a voluntary option allowing customers to  
7 contribute funds that are then distributed through community action agencies  
8 to customers in need. Avista itself contributed \$60,000 to the program in the  
9 past year.
- 10
- 11 • Payment averaging. Comfort Level Billing is the Company's option for  
12 customers to pay the same bill amount each month of the year.  
13
- 14 • Payment arrangements. The Company's Contact Center Representatives work  
15 with customers to set up payment arrangements to pay energy bills.  
16
- 17 • CARES program. Special needs customers have access to specially trained  
18 (CARES) representatives.  
19
- 20 • Customer service automation. Customers are able to access Avista's  
21 Interactive Voice Response system (IVR) for automated transactions such as  
22 to enter their own payment arrangements, listen to outage messages and  
23 conduct other business such as obtaining account balances and requesting a  
24 duplicate bill.  
25

## 26 V. ADVANCED METER READING

27 **Q. Please explain the Company's plans related to advanced meter reading**  
28 **(AMR) in its Idaho service territory?**

29 A. For the past ten years, the Company has been closely following the  
30 development of AMR technology and its potential application at Avista. Until recently, the  
31 cost of AMR technology has been much greater than the benefits that could be achieved on  
32 the Company's system. We believe a combination of decreases in capital and installation  
33 costs of AMR together with expected continuing increases in meter reading expenses now

1 supports the installation of this technology. Over a four-year period beginning in 2005, the  
2 Company plans to upgrade Idaho electric and natural gas meters for automatic reading  
3 capability. This will allow the Company to manage meter reading labor costs, provide  
4 improvements on meter data accuracy, lower customer service costs, and virtually eliminate  
5 estimated meter readings. Mr. Holmes provides an expanded description of the Company's  
6 plans for AMR and associated costs and benefits.

7 **Q. What technology, or type of AMR devices, is the Company proposing to**  
8 **install?**

9 A. As will be explained by Mr. Holmes, the Company plans to utilize a  
10 combination of AMR technologies in its Idaho service territory. We intend to install radio-  
11 based technology in areas with higher meter densities and Power Line Carrier (PLC) based  
12 technology in areas with lower densities. We will continue to use telephone-based  
13 technologies for selected industrial accounts. Avista estimates the costs to install this system  
14 in Idaho to be approximately \$16,300,000, with approximately equal expenditures over a  
15 four year period beginning in January 2005.

16 **Q. Is the Company proposing an adjustment to rates in this filing for AMR**  
17 **equipment and installation?**

18 A. No. The Company is not proposing an increase in rates in this filing  
19 associated with the proposed AMR program. Mr. Falkner will explain the Company's  
20 accounting proposal associated with this program.

1 **VI. OTHER CURRENT AND FUTURE ISSUES**

2 **Q. What are some of the major issues facing the Company in the next three to**  
3 **five years?**

4 A. In the next three to five years Avista will face a number of major issues that  
5 will affect the future costs to provide service to our customers. Among the issues are:

6 **Transmission Upgrades**

7 As Mr. Kopczynski explains in his testimony, to reinforce the electric transmission grid  
8 in eastern Washington and northern Idaho, Avista Utilities, in collaboration with the  
9 Bonneville Power Administration, is building and upgrading transmission infrastructure that  
10 will improve the delivery of electricity to meet existing and future power needs in Avista's  
11 service territory. The projects will relieve current transmission congestion in the area and  
12 improve system reliability. It will also provide additional transmission capacity to meet future  
13 growth needs in the region. These major transmission upgrades began in 2003 and will be  
14 completed in 2006. The projects represent over \$100 million in new infrastructure investment.  
15 Approximately \$26.3 million of these projects will be completed in the near-term and Idaho's  
16 jurisdictional capital costs of \$9 million have been included in this case. The costs associated  
17 with the remainder of the projects will be the subject of a future rate proceeding.

18 **Spokane River Relicensing**

19 Avista's license for the Spokane River hydroelectric projects expires in 2007. These  
20 projects include Post Falls, Upper Falls, Monroe Street, Nine Mile and Long Lake, with a total  
21 generating capacity of 156 MW and average annual energy production of approximately 105  
22 aMw. Since 2001, we have been working with numerous stakeholders to understand and

1 resolve issues related to the Spokane River Project. The first full season of field studies were  
2 completed in 2003, and we are currently reviewing those results. Stakeholders are also  
3 beginning to work on proposals for protection, mitigation, and enhancement measures. Our  
4 goal is similar to what was accomplished on the Clark Fork Project: a comprehensive  
5 settlement agreement defining the terms and conditions of a new license based on a consensus  
6 of local, state and federal agencies, tribes and local citizens. We plan to have a draft license  
7 application ready at the end of 2004, and to file with FERC by July 2005. Mr. Storro provides  
8 additional discussion related to these efforts. The Company is not proposing a change in rates  
9 in this case related to this relicensing process.

#### 10 Cabinet Gorge Dissolved Gas

11 As Mr. Storro explains in his testimony, when the Clark Fork relicensing process was  
12 completed, an issue related to the high levels of dissolved gas occurring during spill periods at  
13 Cabinet Gorge Dam remained unresolved. A plan to mitigate the high total gas levels has  
14 been developed with stakeholders including the Idaho Department of Environmental Quality.  
15 The plan calls for the phased modifications of two existing diversion tunnels with engineering  
16 studies to commence in 2004. The first tunnel would be constructed by 2010 at an estimated  
17 cost of \$37 million, and the second tunnel, if needed, within 10 years of the first tunnel at an  
18 estimated cost of \$23 million. The second tunnel would be constructed only after an analysis  
19 of the performance of the first tunnel and an evaluation of the environmental benefits.  
20 Although preliminary work has begun on the project, the Company has not requested an  
21 increase in rates in this filing.

22

1     Regional Transmission Organization

2             The Company has expended a significant amount of time and effort in recent years  
3 related to the development of a regional transmission organization (RTO). Avista continues to  
4 work with parties throughout the region to pursue the development of a regional transmission  
5 organization solution for the Pacific Northwest. The Company has not included costs  
6 associated with RTO formation in this filing.

7     Volatility of Energy Markets

8             The Company and its customers continue to face the challenges associated with the  
9 volatility of electric and natural gas wholesale market prices. Volatile wholesale prices affect  
10 the costs to the Company's retail natural gas customers, the cost to produce power from the  
11 Company's natural gas-fired generating projects, and the Company's financing requirements in  
12 covering these electric and natural gas purchase costs. The variability of Avista's  
13 hydroelectric generation, in particular, exposes the Company and its customers to the volatile  
14 wholesale electric and natural gas prices, when the Company must purchase replacement  
15 power from the market or run gas-fired generation to cover low streamflow conditions. The  
16 Company continues to focus on resource management and resource procurement strategies that  
17 will reduce exposure to volatile wholesale market prices and provide a level of price stability  
18 for customers.

19             Thus, putting aside the very difficult challenges of the past few years, Avista has a  
20 number of major issues to address in the near future that will require significant investment of  
21 capital and other increased costs.

22             **Q.     Are there any recent developments that you would like to address?**



1 Avista's employees continue to collaborate on innovative ideas. *The Conservation*  
2 *Fund Year in Review, 2002* stated: "For the fourth straight year, Avista Corporation has  
3 received an Outstanding Stewards of America's Rivers award from the National Hydropower  
4 Association. The group honored the energy company for its preservation work in the Clark  
5 Fork River basin."

6 The Kettle Falls Generating Station, the first wood waste-fired plant in the United  
7 States built by a utility solely for the generation of electricity, is marking its 20<sup>th</sup> anniversary.  
8 This plant has won several awards such as the Washington State's Environmental Excellence  
9 Award for reducing emissions from burning waste in open wigwam burners and *Power*  
10 *Magazine's* Energy Conservation Award.

11 The Company continues to further transmission reliability for the benefit of our  
12 customers and the region as a whole. In addition to what are known as the West of Hatwai  
13 projects that will be described by Mr. Kopczynski, the Company has pioneered the use of a  
14 "Star Network," or radial design to reduce transmission losses as well as to increase reliability  
15 to our customers and reduce the number of customers affected by transmission outages.

16 However, I am most pleased with the response of Avista Utilities' employees in the past  
17 three years as the Company faced its most serious financial challenge in its 114 year history.  
18 Employees have maintained quality customer service and reliability while challenged to do  
19 more with less. While we have maintained tight controls on capital and O&M budgets, our  
20 customer service surveys indicate that customer satisfaction has remained high. Our most  
21 recent overall customer satisfaction survey results show a satisfied customer rating of 89.1% in

1 our Idaho and Washington operating divisions. These results can be achieved only with very  
2 committed and competent employees.

3  
4 **VII. OTHER COMPANY WITNESSES**

5 **Q. Would you please provide a brief summary of the testimony of the other**  
6 **witnesses representing Avista in this proceeding?**

7 A. Yes. The following witnesses are presenting direct testimony on behalf of  
8 Avista.

9 Mr. Malyn Malquist, Senior Vice President and Chief Financial Officer will describe,  
10 among other things, the overall financial condition of the Company, its current credit ratings,  
11 the Company's plan for a return to investment grade credit ratings, the proposed capital  
12 structure, and the return on equity requested by the Company. Mr. Malquist explains that:

- 13 • The Company's credit rating is below investment grade for unsecured debt  
14 having been severely impacted by the Western energy crisis of 2000 and 2001;
- 15 • Avista is aggressively rebuilding its financial health including retiring higher  
16 cost debt and conserving cash through strategic initiatives;
- 17 • The Company has proposed an overall rate of return of 9.82%, including a  
18 44.3% equity ratio and an 11.5% return on equity;
- 19 • Although the analyses of Dr. Avera and Dr. Wilson support a return on common  
20 equity in excess of 11.5%, Avista has limited its request to 11.5% in an effort to  
21 balance the competing objectives of Avista regaining its financial health within  
22 a reasonable period of time, and the impacts that increased rates have on our  
23 customers;
- 24 • This general rate request for electricity and natural gas in the State of Idaho is an  
25 important component in the continuing improvement of Avista's financial  
26 condition, providing the opportunity to regain an investment grade credit rating.

27  
28 Dr. William E. Avera, as a principal in Financial Concepts and Applications (FINCAP),  
29 Inc., has been retained to present testimony with respect to the Company's cost of capital and  
30 capital structure. He concludes that:

- 1 • Analyses related to the cost of common equity for a benchmark group of electric  
2 utilities in the western U.S. yields an ROE in the range of 10.4% to 11.9%;
- 3 • The investment risks associated uniquely with Avista, however, are significantly  
4 greater than those of the utilities in the benchmark group and investors require a  
5 higher rate of return to compensate for that risk;
- 6 • Based on capital market analyses and the economic requirements for electric  
7 utility operations, an 11.5% ROE falls below the current required rate of return  
8 for Avista, in light of investors' economic requirements and the Company's  
9 specific risks;
- 10 • The challenges imposed by the evolving structural changes in the industry imply  
11 that utilities will be required to incorporate relatively greater amounts of equity  
12 in their capital structures. The total equity ratio of 44.3% proposed by Avista in  
13 this case would barely meet the targets that Standard & Poors expects for an  
14 investment grade rated utility.

15  
16 Dr. William Wilson, a Senior Economist at Ernst and Young, will explain his  
17 methodology for assessing industry risk and operating company risk, and the resulting return on  
18 equity for Avista based on this methodology. Dr. Wilson will:

- 19 • Demonstrate a marked increase in volatility of operating earnings as a  
20 percentage of rate base among regulated electric utility operating companies  
21 during the 1998-2002 period, when compared to prior periods. Higher volatility  
22 implies higher risk. Allowed rates of return in the utility industry have not been  
23 adjusted to reflect this higher risk;
- 24 • Present a methodology to recognize the risk profile of electric utility operating  
25 companies that incorporates data from 116 regulated electric utilities;
- 26 • Identify and analyze twelve key variables to assess the risk of an individual  
27 utility relative to other utilities in the industry;
- 28 • Conclude that the analysis, including consideration of the specific operating  
29 risks of Avista, supports an ROE for Avista at the higher end of an ROE  
30 bandwidth from 11.08% to 13.32%.

31  
32 Mr. Richard Storro, Director of Power Supply, will present an overview of resource  
33 planning and power operations, will address the Commission's PCA Order regarding Risk  
34 Policy, and will describe the Company's hydro-relicensing activities related to the Clark Fork  
35 and Spokane Rivers. He explains:

- 1 • Avista is in a surplus or balanced energy position through 2007 on an average  
2 annual basis. The Company has an average energy deficit of 22 aMW in 2008  
3 and increases to 333 aMW in 2014;
- 4 • The Company intends to continue the preferred resource strategy laid out in its  
5 recent 2003 Integrated Resource Plan, which is a combination of market  
6 purchases, energy efficiency, renewable resources, combined cycle combustion  
7 turbines, and coal-fired generation;
- 8 • Avista is upgrading its Cabinet Gorge Project Unit #2, and is applying the very  
9 successful approach it used in the relicensing of its Clark Fork projects to its  
10 Spokane River facilities relicensing process;
- 11 • Mr. Storro also addresses the Company's Energy Risk Policy as it relates to its  
12 procurement strategies.

13  
14 Mr. Robert Lafferty, Manager, Wholesale Marketing & Contracts, among other things,  
15 will address the Company's selection of the Coyote Springs 2 (CS2) generating project, the  
16 management of CS2 construction issues and the reasonableness of certain gas supply contracts  
17 deferred to this case by the Commission from the Company's 2003 PCA case. Mr. Lafferty  
18 demonstrates that:

19 With regard to the CS2 Project:

- 20 • The Company's selection of CS2 as a resource from its 2000 all-resource  
21 Request For Proposal process was reasonable. The Company reasonably and  
22 fairly evaluated 32 proposals from 23 bidders, which resulted in the selection of  
23 CS2 as the supply-side resource;
- 24 • It was reasonable to sell 50% of the CS2 project to Mirant, given the financial  
25 challenges facing the Company;
- 26 • The Company, along with its CS2 partner Mirant, took reasonable steps to bring  
27 the CS2 project to commercial completion as quickly as practical when taking  
28 into account the impacts of the Enron/NEPCO bankruptcies and the generator  
29 step-up transformer delays. The costs associated with the CS2 project are  
30 reasonable and should be approved for recovery.

31  
32 With regard to issues deferred from the 2003 PCA:

- 33 • The Company's decisions to purchase index-based firm delivered natural gas for  
34 CS2, with delivery flexibility to provide fuel supply to other natural gas-fired  
35 generation projects, were reasonable;
- 36 • The Company's decision to fix the price of a portion of its index-based natural  
37 gas, by entering into four medium-term hedge transactions, was based on its

1 need for resources to serve net system load, which resulted in a lower cost to  
2 generate power compared to purchasing electric power in the market;  
3 • The Company periodically enters into medium-term power transactions, such as  
4 the hedged transactions. The decision to enter into the transactions was  
5 reasonable, based on the information available at the time.  
6

7 Mr. William Johnson, Senior Power Supply Analyst, will describe the adjustments to  
8 the 2002 test period power supply revenues and expenses. Mr. Johnson describes:

- 9 • The Company's adjustments to the 2002 test period power supply revenues and  
10 expenses. These adjustments are designed to reflect the normalized level of  
11 revenues and expenses, and to include known and measurable changes to the  
12 revenue and expense items;  
13 • The increase in net power supply expenses since the Company's last general rate  
14 case of approximately \$11 million (Idaho share). The two primary changes  
15 include the reduction in wholesale sales revenue (PGE capacity sale) of \$6  
16 million, and an increase in net fuel expense for thermal generation (primarily  
17 CS2) of \$4.5 million;  
18 • The Company's updated base costs to be used in future Power Cost Adjustment  
19 calculations.  
20

21 Mr. Clint Kalich, Manager of Power Supply Planning and Analysis, will describe the  
22 Company's Aurora model inputs, assumptions, and results related to the economic dispatch of  
23 Avista's resources to serve load requirements. He explains that:

- 24 • The AURORA system dispatch model more accurately reflects the true system  
25 dispatch of Avista's resources on an hourly basis, than the prior model that used  
26 monthly data;  
27 • The model dispatches Avista's generation resources and contracts on an hourly  
28 basis in a manner that maximizes benefits to customers;  
29 • The output results from the model, including thermal generation and short-term  
30 wholesale sales and purchases, were provided to Mr. Johnson to incorporate into  
31 the power supply proforma adjustments.  
32

33 Mr. Don Kopczynski, General Manager of Energy Delivery, will describe Avista's  
34 energy delivery operations, the Company's vegetation management program, and the major  
35 transmission upgrades currently in progress. Mr. Kopczynski describes:

- 1 • Avista's customer service programs such as energy efficiency, Project Share,  
2 and payment plans. Some of these programs will serve to mitigate the impact  
3 on customers of the proposed rate increase;
- 4 • The effort, in collaboration with the Bonneville Power Administration, to build  
5 and upgrade transmission infrastructure that will improve the delivery of  
6 electricity to meet existing and future power needs in Avista's service territory;  
7 The projects represent over \$100 million in new infrastructure investment that  
8 will be completed by 2006;
- 9 • Avista's comprehensive and professionally-staffed vegetation management  
10 program that reduces customer outages, improves safety, and enhances system  
11 reliability.

12  
13 Mr. David Holmes, Manager of Distribution Engineering, will present the Company's

14 plan to implement an advanced meter reading (AMR) program. Mr. Holmes explains:

- 15 • The Company plans to install meter upgrades to Idaho electric and natural gas  
16 meters over a four-year period beginning in 2005 at a cost of approximately  
17 \$16.3 million;
- 18 • The benefits include savings in meter readings, customer billing, maintenance  
19 expense, and future customer service enhancements;
- 20 • The Company does not seek an increase in rates at this time for AMR costs.

21  
22 Mr. Don Falkner, Manager of Revenue Requirements, will discuss the Company's

23 overall revenue requirement proposals. In addition, his testimony and exhibits in this  
24 proceeding will generally cover accounting and financial data in support of the Company's need  
25 for the proposed increase in rates. He sponsors:

- 26 • Electric and natural gas revenue requirement calculations;
- 27 • Electric and natural gas results of operations;
- 28 • Proformed operating results including expense and rate base adjustments;
- 29 • System and jurisdictional allocations;
- 30 • Advanced Meter Reading accounting proposal.

31  
32 Ms. Tara Knox, Rate Analyst, sponsors the cost of service studies for electric and

33 natural gas service and the weather normalization adjustments to retail usage. Ms. Knox studies  
34 indicate:

- 1           •     Electric service residential and extra large service schedules are earning  
2                   substantially less than the overall rate of return under present rates;  
3           •     Gas general service schedule 101 (primarily residential customers) is earning  
4                   slightly less than the overall return, all other schedules are earning more than the  
5                   overall return, but less than the requested return;  
6           •     Mr. Hirschhorn incorporates these findings in his rate spread recommendation.  
7

8           Mr. Brian Hirschhorn, Manager of Retail Pricing, discusses the spread of the proposed

9           annual revenue changes among the Company's general service schedules and addresses the

10          Company's revenue normalization adjustment. He explains that:

- 11           •     The proposed annual net electric revenue increase is \$18,871,000, or 11.0%.  
12                   The net increase consists of a proposed general increase of \$35,222,000 as well  
13                   as the proposed reduction in the present Power Cost Adjustment (PCA)  
14                   surcharge of \$16,351,000;  
15                   o     The proposed increase for a residential customer using an average of 941  
16                            kwhs per month is \$7.85 per month, or a 13.9% increase in their electric bill.  
17                            The present bill for 941 kwhs is \$56.52 compared to the proposed level of  
18                            \$64.37;  
19                   o     As part of that increase, the Company is proposing that the basic / customer  
20                            charge be increased from \$4.00 to \$5.00 per month;  
21                   o     The Company is proposing to add an energy usage rate block to each of its  
22                            electric general service schedules (Schedules 11, 21 and 25), whereby the  
23                            larger customers served under those schedules would pay a lower  
24                            incremental energy rate for usage beyond a certain level;  
25                   o     Since the Company's last general rate case, usage per customer appears to  
26                            have declined significantly for all customer classes. From 1997 (last general  
27                            case test year) to 2002, residential use per customer has declined from 1,037  
28                            kwhs per month to 941 kwhs, or about 9%. Use per customer has declined  
29                            about 8% for commercial and industrial customers during that time, and  
30                            about 14% for the Company's largest fourteen customers served under  
31                            Schedule 25;  
32                   o     The Company is proposing changes to the present Schedule 25 rate structure  
33                            that will result in Potlatch paying an average rate per kwh that is lower than  
34                            the average rate(s) paid by other Schedule 25 customers;  
35           •     The proposed natural gas annual revenue increase is \$4,754,000, or 9.2%;  
36                   o     The increase for a residential customer using an average of 73 therms of gas  
37                            per month would be \$5.75 per month, or 9.6%, which includes a proposed  
38                            increase in the monthly basic / customer charge from \$3.28 to \$5.00;  
39                   o     A bill for 73 therms per month would increase from the present level of  
40                            \$60.01 to a proposed level of \$65.76;

- 1           •     The Company requests that the Commission issue a finding that electric energy  
2           efficiency expenditures from January 1, 1999 through December 31, 2003 and  
3           natural gas energy efficiency expenditures from March 13, 1995 through  
4           December 31, 2003 were prudently incurred.  
5  
6           **Q.     Does this conclude your pre-filed direct testimony?**  
7           **A.     Yes.**