BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

CASE NO. AVU-E-01-11

REBUTTAL TESTIMONY OF KELLY O. NORWOOD

REPRESENTING AVISTA CORPORATION

Q. Please state your name, the name of your employer and your business address.

A. My name is Kelly O. Norwood. I am employed by Avista Corporation at 1411 East Mission Avenue, Spokane, Washington.

Q. Have you previously filed direct testimony in this proceeding?

A. Yes.

Q. What is the scope of your rebuttal testimony?

A. My rebuttal testimony will respond to the testimony of Dr. Peseau submitted on behalf of Potlatch Corporation. I will also address Mr. Hessing's concern at page 5 of his direct testimony regarding actual sales for resale being significantly above the normalized base level.

Q. Do you have any opening remarks related to the testimony of Dr. Peseau?

A. Yes. Dr. Peseau has drawn conclusions that are inconsistent with the factual evidence in this case. Furthermore, many of the questions or concerns raised by Dr. Peseau have been either already addressed in this case, or were covered in the investigation conducted by Staff. In this regard, Potlatch did not submit a single data request to Avista, and did not visit the Company's offices or call the Company to gather information regarding the filing. This is in sharp contrast to Commission Staff that not only submitted data requests to the Company and made a number of phone calls to gather information, but also sent a Staff representative to Avista's offices for the majority of a week (4 days) to audit the Company's filing.

Q. Has Dr. Peseau acknowledged the need for emergency rate relief?

A. Yes. He testifies that Avista has offered a prima facie case for emergency rate relief. He also recognizes that the Company has experienced more price volatility and escalating prices in the Northwest electricity markets than ever before. Finally, he acknowledges the record low streamflows experienced by the Company. His recommendations, however, are not responsive to Avista's needs.

Q. What is your first area of concern regarding Dr. Peseau's testimony?

A. On page 4 of his testimony, Dr. Peseau states his understanding that Avista "went 'long' on power supplies at fixed prices in the hope of hedging potentially higher summer 2001 prices." Further, on page 5, line 5, he states that "The steep climb in projected balances from July 2001 to January 2002 indicates the damage done by Avista's long position."

Dr. Peseau's statement that the Company took "long" positions implies that Avista purchased more power than it needed for the summer of 2001. The reason a position is called "long" is because the energy is surplus or in excess of the power needed to cover load requirements. At any given time, Avista is either "long" (surplus), "even," or "short" (deficient) energy.

As I explained in my pre-filed direct testimony, the record low streamflow conditions required the Company to purchase additional energy from the short-term market to replace the lost hydroelectric generation. Thus, these purchases were made to cover the <u>deficiencies caused by the low hydro conditions</u> so that the Company would have sufficient resources to cover its load requirements. The purchases were clearly not made to create a "long" position.

Q. Did Commission Staff review these purchases in their audit of the Company's filing?

A. Yes. Through the discovery process Staff specifically requested copies all of the firm contractual commitments for electricity purchases for the period July through December 2001.

Q. On page 6 of his testimony, Dr. Peseau suggests that there is a “simple means to lower the average power prices” incurred by Avista by simply “extending the term of purchase to reflect the much lower prices now available on the market”. Do you agree with his suggested means of mitigating July through December 2001 power prices?

A. No. The purchases made by Avista were for specific blocks of power for specific periods of time. Avista purchased the quantity of power it needed to cover its deficiencies as hydroelectric generation and system load requirements changed. Dr. Peseau seems to suggest that Avista should purchase more power than it needs by extending the terms of power deliveries just to achieve a lower average price. However, Dr. Peseau has apparently overlooked the fact that if the Company made additional purchases of power at market prices, it would also need to resell the power at market prices. To purchase additional power at market prices, that is not needed, and then resell the power at the same market prices would leave the Company with the <u>same level of net costs</u>. Such a plan would also introduce additional risks such as the risk of being able to resell the power at a price equal to or greater than the purchase price as well as credit risks.

Q. On page 5, line 8, of his testimony, Dr. Peseau states that the "projected deferral balances after January 2002 are based on July 3, 2001 forward prices," and that forward prices have declined since that time. He then concludes that, "Substituting current forward prices would undoubtedly show a decrease in the projected deferred balances beginning in January 2002." Is Dr. Peseau's conclusion correct?

A. No. Although Dr. Peseau is correct that the projected balances were based on July 3, 2001 prices, and prices have declined since that time, the effect of the decline in prices is just the opposite of the conclusion that he has drawn. As the Company explained in its filing, projections show that Avista has surplus energy available in 2002 and 2003. A decline in forward prices, however, results in a decrease in the value of that surplus energy, and further reduces the opportunity to offset the deferred costs that are accumulating in 2001. Therefore, any decline in forward prices makes it that much more important to implement the PCA increase proposed by the Company to address recovery of the deferred cost balance.

Q. Dr. Peseau states in his testimony that Avista's request is not advisable because granting immediate relief for projected deferral balances would greatly reduce Avista's incentive to mitigate the high contract wholesale market prices. Do you agree with his statement?

A. No. The PCA mechanism includes a 90%/10% sharing between customers and the Company. In discussions with Staff regarding the adoption of such a sharing, part of Staff's justification for the sharing was to provide an incentive for the Company to make decisions that are in the best interest of its customers. Furthermore, even apart from this sharing mechanism, it is in the Company's interest to keep costs, and thereby rates low, to maintain customer satisfaction and to remain competitive with other utilities.

Q. Dr. Peseau has recommended a separate proceeding to review the reasonableness of the deferred costs, and proposes that the PCA increase be approved subject to refund. Do you agree with these recommendations?

A. No. The PCA has been in place since 1989, during which time there have been nine rebates to customers and four surcharges. The rebates to customers have totaled $23.2 million and the surcharges have equaled $12.5 million. The Commission Staff has conducted a review of the costs and revenues recorded in the PCA prior to a surcharge or rebate being implemented. In addition, the Company has provided monthly reports of PCA deferral entries to allow an ongoing review of deferred costs.

Q. Are the nature of the costs in this case similar to the costs reviewed in prior PCA requests?

A. Yes they are. The costs and revenues reviewed in this case are of the same nature as those of prior PCA reviews. In this case, the magnitude of the numbers is increased due to high market prices and record low hydroelectric conditions.

Q. Did the Commission Staff conduct a review of the deferred power costs incurred by the Company in this case?

A. Yes, they did. Ms. Stockton describes the review conducted by Staff. As I stated earlier, the Commission Staff submitted data requests to the Company, made a number of phone calls to Avista to gather information, and sent a Staff representative to Avista's offices to audit the Company's filing.

Q. Is there a means for the Commission to review the costs associated with the Company's long-term resource decisions that may be included in the PCA entries?

A. Yes there is. The PCA contains provisions for a review of the Company long-term resource decisions. The Commission's order in Case No. AVU-E-01-11, regarding the inclusion of generation additions and long-term power purchases and sales, states as follows:

> Staff recommends that other generation additions and power supply contracts with terms longer than one year be submitted to the Commission for review and Commission approval. Staff understands that actual accounting entries will be effective starting with the delivery of energy. If for some reason Commission approval for PCA treatment is not granted, the cost differences can be unwound. (Page 5)
>
> Regarding the inclusion of long term purchase and sales contracts in the PCA mechanism, Avista accepts Staff's recommendation that generation additions and power supply contracts with terms longer than one year be submitted to the Commission for review and Commission approval. (Pages 5,6)

Actual deferrals through June 30, 2001 do not include costs associated with new long-term resources. In the future, there will be an opportunity to review new long-term resource decisions prior to the Commission approval of those costs for inclusion in rates.

Q. Dr. Peseau expresses concern regarding the use of projections in this case. Do you have any comments on this portion of his testimony?

A. Yes. As Mr. Falkner explained in his direct testimony, a 27-month recovery period was chosen to provide recovery of the deferred costs over a reasonable period of time, while also reducing the overall impact on customers, as compared to a shorter recovery period. Although projections were used in the initial determination of the level of the PCA increase, for the reasons discussed, <u>only actual costs will be recovered through the PCA</u>. As the Company explained in its direct case, the PCA increase necessary to recover the actual balance of deferred costs at the end of June 2001 over a 12-month period would result in an increase of 20%, as compared to the Company's proposed increase in this case of 14.7%.

The Company has proposed to file to adjust the PCA rates during the 27-month period. Furthermore, Commission Staff has proposed, and the Company is in agreement, that the Company make annual formal filings including actual PCA deferrals and recommendations on whether rates should be modified. That will provide an additional level of oversight.

Q. On page 8 of Dr. Peseau's testimony, he raises concerns regarding the Centralia sale. Do you have any comments on this portion of his testimony?

A. Yes. The sale of Centralia was approved by the Commission's Order No. 28297 in Case No. AVU-E-99-6 dated March 7, 2000. The Company made a medium-term power purchase to replace the Centralia generation. The Commission has already ruled on the prudence of the sale. Page 6 of Order No. 28775 in Case No. AVU-E-01-1 dated July 11, 2001 addresses how the Centralia fixed and variable costs are to be credited in the PCA mechanism and the replacement power costs are to be included in the mechanism. The Commission's Order at page 6 states, "As agreed to by the Company and Staff, the Centralia generating station will be replaced in the modified PCA by the replacement power costs for Centralia coupled with a credit for the fixed and variable costs of Centralia reflected in rates (i.e., fuel, operation, maintenance, depreciation, taxes, and return on investment)."

Q. Dr. Peseau poses a question about "the relationship between Avista's regulated and unregulated trading activities". Would you please explain that relationship?

A. Yes. Avista Utilities operates its owned and contracted resources in a manner to optimize the value of the resources in serving its load requirements. Avista Energy was set up as a separate, non-regulated subsidiary of the Company, and the Avista Energy power supply operations are independent of the power supply operations in the Energy Resources Department of the utility. The electric resources within the utility are not used in any way to support the operations at Avista Energy.

Q. On page 9 of his testimony, Dr. Peseau raises the issue of whether the Company's unregulated businesses have contributed to the current financial situation. Do you have any comments on this testimony?

A. Yes. The deterioration of the Company's financial condition during 2000 and 2001 is primarily due to the unexpected need to fund the more than $300 million we have 'invested' in deferred electric and gas costs, while also investing approximately $190 million in the Coyote Springs II resource.

In fact, we believe that Avista Capital, which is composed of Avista's unregulated subsidiaries, will be a net contributor of cash to Avista in 2001-2002, not a net cash drain on the Company. In addition, the earnings contribution of Avista Energy has been critical to support the total earnings and equity of the Company.

Q. Would you please address Mr. Hessing's question on page 5, line 17, related to Sales for Resale revenues being significantly above normal or authorized levels in a period when the Company is short on resources and purchasing energy?

A. Yes. Sales for Resale increased $288 million over the authorized level for the period January 2001 through June 2001. There are two primary reasons for this large increase in Sales for Resale revenue. Approximately two-thirds of the increase ($189 million) is related to four transactions involving simultaneous purchases and sales of energy at market index prices. During this period, the Company had two 100 aMW index sales, and two offsetting 100 aMW index purchases. The Sales for Resale and Purchased Power dollars are much higher than the authorized amounts because of the high market index prices during the period. These index sale and purchase transactions were separately identified in the Company's last general rate case.

The remaining one-third of the increase in Sales for Resale revenue ($96 million) is related to short-term sales transactions. Because of the variability of the Company's loads and resources, the Company makes short-term purchases and sales of energy on a regular basis, especially on a pre-schedule (next day) and real-time (hour-to-hour) basis. Because of the high power prices during the period the revenue from these sales was much higher than the authorized sales revenue.

Q. Does that conclude your rebuttal testimony?

A. Yes, it does.