

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is Dennis E. Peseau. My business address is Suite 250, 1500 Liberty
3 Street, S.E., Salem, Oregon 97302.

4 Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?

5 A. I am the President of Utility Resources, Inc. ("URI"). URI has consulted on a
6 number of economic, financial and engineering matters for various private and
7 public entities for more than twenty years.

8 Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK
9 EXPERIENCE.

10 A. My resume is attached as Exhibit No. 201. I have testified before the Idaho
11 Public Utilities Commission on various revenue requirement and cost of service
12 issues on numerous occasions since the early 1980s.

13 Q. FOR WHOM ARE YOU APPEARING IN THIS CASE?

14 A. I am appearing on behalf of Potlatch Corporation.

15 Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

16 A. The purpose of my testimony is to briefly review the circumstances that cause
17 Avista Corporation ("Avista") to request in excess of \$53 million in extraordinary
18 and expedited rate relief over a twenty-seven month period and seek an
19 additional \$34.6 million in an accelerated credit on the PGE transaction. Given
20 the short lead time in this case, I have not attempted to investigate every facet of
21 Avista's request, but have instead concentrated on what I consider to be the
22 most important policy issues.

1 My testimony recommends that the Commission grant only a portion of the
2 relief requested. I agree that Avista should recover its power cost expenses
3 incurred to date, but I do not agree with the request to recover anticipated future
4 power supply expenses that have not yet been incurred or recorded. Moreover,
5 any increase approved by the Commission, of expenses incurred to date as well
6 as any future expenses, should be subject to refund after a prudency review is
7 conducted. This prudency review should be conducted in a timely but thorough
8 manner.

9 Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.

10 A. In my judgment, Avista's testimony offers a prima facie case for emergency rate
11 relief. But I would also point out that emergency relief should be granted very
12 sparingly, and it should always be subject to refund if there are any questions
13 about either the reasons for, or size of, the request. In the present case, there
14 are a number of issues that cannot be resolved in this expedited proceeding.

15 Accordingly, I conclude that:

- 16 1. Avista in this proceeding is not requesting a PCA surcharge in any normal
17 sense of PCA proceedings. Avista is really requesting a rate increase
18 based on projected costs and events over a twenty-seven month future
19 test period.
20
- 21 2. The apparent need for this approximate \$88 million request is largely the
22 result of a market position Avista took beginning in late 2000 on power
23 supplies for the period July 1 - December 31, 2001. It turns out that this
24 position was a bad one.
25
- 26 3. Avista in this proceeding ought to be granted a rate increase of no more
27 than 14.7%, but not for the twenty-seven month period requested by the
28 Company.

- 1
2 4. The IPUC staff and other parties should be given an opportunity to
3 investigate the prudence of Avista's management of its resources and
4 power supply purchases. If the Commission decides to grant Avista's
5 request for emergency relief in this case, the necessary review should
6 take place in a follow up proceeding. Any relief granted in this proceeding
7 should be subject to refund pending the completion of this review.
8
9 5. Shortly after December 31, 2001, Avista should be allowed to file for
10 additional relief based on its July 1, 2001 to December 31, 2001 recorded
11 balances comparing actual power costs to PCA rates.
12

13 Q. PLEASE EXPLAIN IN GREATER DETAIL THE REASONS FOR THE AVISTA
14 RATE REQUEST?

15 A. In the last sixteen months we have witnessed more price volatility and escalating
16 prices in the Northwest electricity markets than ever before. Avista witnesses
17 explain in detail this price behavior. As a result of these escalating prices, some
18 level of rate increase may be expected. But, despite record low streamflows and
19 rising market prices, certain circumstances in Avista's rate request are unique.

20 These circumstances are highlighted in the following quotes:

21 “.. The dramatic increase in the PCA balance of \$30 million (Idaho
22 jurisdiction) at June 30, 2001 to \$72 million (Idaho jurisdiction) at
23 December 31, 2001 is driven primarily by purchases at high prices in the
24 short-term market to cover the deficiencies for July-December caused by
25 the record low stream flow conditions for Avista.” (Kelly Norwood, Page
26 7; emphasis added.)
27

28 “... The Company chose to cover those deficiencies in advance through
29 short-term fixed-price contracts among other measures, rather than risk
30 the potential for even higher prices as the summer drew nearer ...” (Kelly
31 Norwood, Page 8, Lines 1-3; emphasis added.)
32

33 “... It was the Company's intent that surplus power resources available in
34 2002 and 2003 would be sold into the wholesale market to work the

1 deferred cost balances back to zero. However, although forward power
2 prices are still above historic levels embedded in our retail rate cost
3 recovery structure, the value of surplus sales will not be adequate to offset
4 current deferral balances and additional amounts that will be deferred
5 during the remainder of 2001 ..." (Jon Eliassen, Page 4, Lines 14-19.)
6

7 Thus Avista went "long" on power supplies at fixed prices in the hope of hedging
8 potentially higher summer 2001 prices, and to have surplus power from new
9 generating plants to sell into the wholesale markets at a significant profit in 2002
10 and 2003. Unfortunately, a different market strategy would now appear to have
11 been a better alternative.

12 Q. ARE YOU STATING THAT AVISTA'S PURCHASING ACTIVITIES ON BEHALF
13 OF ITS REGULATED ELECTRIC UTILITY WERE IMPRUDENT?

14 A. No. At this juncture, there is insufficient evidence to determine whether or not
15 Avista's actions were prudent. I will propose below a means that will allow
16 parties a prudency review at a time when future actual PCA deferral balances are
17 known.

18 Q. WHAT IS THE SIGNIFICANCE OF THE JULY 1, 2001 TO DECEMBER 31, 2001
19 PERIOD?

20 A. As the quotes above indicate, Avista predicts that its PCA deferred balances will
21 increase by \$42 million during this six-month period alone. This is despite the
22 fact that wholesale market prices have fallen precipitously since June. For
23 reasons that are only touched upon in Avista witnesses' direct testimony, Avista
24 apparently acquired power supplies beginning in late 2000 for the July through
25 December 2001 period. Avista's timing could hardly have been worse, and the

1 economic consequences are, to say the least, very unfortunate. Wholesale
2 prices both before and after late 2000 and early 2001 were much more favorable.

3 To highlight the significance in these proceedings of the period July 1 -
4 December 31, 2001, I refer to Avista Exhibit No. KON-3, Page 6 of 6, which I
5 reproduce as my Exhibit 202. The steep climb in projected balances from July
6 2001 to January 2002 indicates the damage done by Avista's long position.

7 Q. ARE THERE ANY OTHER NOTEWORTHY ASPECTS OF EXHIBIT 202?

8 A. Yes. As the exhibit states, the projected PCA deferred balances after January
9 2002 are based on July 3, 2001 forward prices. These prices no longer
10 represent existing realities. As of this writing, Northwest forward prices are
11 approximately \$33/mwh. Substituting current forward prices would undoubtedly
12 show a decrease in the projected deferred balances beginning in January 2002.

13 This precipitous price drop illustrates the point that Avista's request to set
14 rates today for projected deferral balances through December 2003 is neither
15 necessary nor advisable to cope with the Company's stated financial difficulties.

16 Q. WHY DO YOU STATE THAT SETTING A PCA RATE IN THESE
17 PROCEEDINGS FOR THE COMPANY'S REQUESTED TWENTY-SEVEN
18 MONTH PERIOD IS NEITHER NECESSARY NOR ADVISABLE?

19 A. The twenty-seven month deferral period requested by Avista is not necessary
20 because Avista's actual PCA deferral balances in its filing are \$30 million, not the
21 \$88 million it seeks authority to collect. Authorizing a full 27-month recovery is

1 not necessary to protect Avista's bond ratings and forestall the immediate cash
2 flow problems Avista anticipates.

3 The Avista request is not advisable because granting immediate relief for
4 projected deferral balances would greatly reduce Avista's incentive to mitigate
5 the high contract wholesale market prices. Moreover, Avista's proposal is
6 subject to all the usual infirmities that accompany ratemaking based on projected
7 costs.

8 Q. ARE THERE MEANS AVAILABLE TO AVISTA TO MITIGATE THE JULY 1 -
9 DECEMBER 31, 2001 POWER PRICES IT HAS APPARENTLY LOCKED IN?

10 A. Quite possibly. One simple means to lower the average power prices is to
11 extend the term of purchase to reflect the much lower prices now available on the
12 market. There may well be other mitigation measures that could be taken, but
13 there is no way to assess these possibilities in such an accelerated proceeding.

14 Q. ARE YOU RECOMMENDING THAT AVISTA EXTEND THE TERM OF THE
15 JULY 1 - DECEMBER 31, 2001 CONTRACTS?

16 A. No, not without further study. What I am recommending is that Avista be given
17 every opportunity and incentive to correct and mitigate these high-cost contracts.

18 Q. DO YOU HAVE A RECOMMENDATION THAT LIMITS AVISTA'S RECOVERY
19 TO ACTUAL PCA DEFERRAL BALANCES, BUT ALSO GIVES IT INCENTIVES
20 TO REDUCE FUTURE POWER COSTS?

21 A. Yes. I recommend first that, in this proceeding, Avista be allowed to raise its
22 rates by no more than the net 14.7% it requests, and for no more than a twelve-

1 month period. This would allow it to begin collecting the present June 30, 2001
2 balance of \$30 million. This recovery should be accomplished in a manner
3 similar to that proposed by Avista. That is, the \$30 million should be recovered
4 over twelve months from the 14.7% PCA increase, plus whatever accelerated
5 PGE monetization credit is necessary to make the exact \$30 million recovery.
6 This gives Avista a cash infusion for the near term.

7 I also recommend that the Commission schedule a proceeding to
8 thoroughly investigate the prudence and reasonableness of Avista's power
9 supply purchases and mitigation efforts. At such time, Avista should be required
10 to justify its power purchase policies leading up to the high cost contracts as well
11 as all mitigation practices it has undertaken since. The most convenient time for
12 this review would be shortly after January 1, 2002, at which time Avista also
13 should be allowed to file for recovery of any PCA deferral balances from the
14 period July 1, 2001 - December 31, 2001.

15 In the meantime, the increase approved in this proceeding should be
16 subject to refund, in whole or in part, if Avista fails to prove that its power supply
17 management has been prudent.

18 Q. ARE THERE ANY OTHER REASONS WHY THE COMMISSION SHOULD NOT
19 GRANT THE FULL TWENTY-SEVEN MONTHS OF RELIEF AVISTA IS
20 REQUESTING?

21 A. Yes. The request is essentially equivalent to an extended future test year,
22 despite the Company's intent to eventually substitute actual costs for the

1 projected costs contained in its filing. Granting an emergency increase on this
2 basis would establish a terrible precedent that would alter the balance of
3 responsibilities and risks between shareholders and ratepayers.

4 My proposal would grant Avista rate relief and an immediate increase in
5 cash flow on an expedited basis, although for a briefer period of time than Avista
6 requests. But a follow up prudency review would also protect the ratepayers
7 from the possibility that this expedited proceeding may result in rates that are
8 ultimately proved to be unjustified. Scheduling a complete and timely review of
9 this matter provides a measure of protection to both Avista and the ratepayers.

10 Q. YOU STATE THAT ANY INCREASE SHOULD BE SUBJECT TO REFUND
11 PENDING A PRUDENCY REVIEW. WHAT ARE THE ISSUES THAT SHOULD
12 BE EXAMINED IN SUCH A REVIEW?

13 A. I cannot predict all the issues that might arise if Avista's power supply
14 management is subject to a detailed examination. However, some issues are
15 obvious. Beginning with the Centralia sale, Avista made a decision to rely more
16 heavily on market purchases than it had previously. The Commission needs to
17 determine whether this strategy was prudently adopted and competently
18 managed. Obviously the relationship between Avista's regulated and
19 unregulated trading activities will be a prominent issue in this investigation.
20 Finally, the Commission must consider whether Avista's mitigation efforts are
21 properly executed.

1 Q ARE THERE ANY OTHER ISSUES THAT REQUIRE FURTHER
2 INVESTIGATION?

3 A. Yes. Avista's request for emergency relief is largely predicated on the need to
4 immediately generate additional cash flow to preserve its bond ratings and
5 continue the funding of construction projects, the most notable of which is the
6 Coyote Springs II facility. While Potlatch is not taking a position in these
7 proceedings on the Coyote Springs II project or other generation projects, clearly
8 the recent dramatic drop in market prices requires a reassessment of Coyote
9 Springs' economic feasibility and timing.

10 Avista also needs to explain and justify the extent to which its unregulated
11 businesses have contributed to its current financial difficulties. From prior cases
12 and trade news, the Commission should be somewhat familiar with the scope
13 and financial results of Avista Energy's trading activities. But this is not the only
14 unregulated activity that impacts the earnings and cash flow of the parent
15 company. To cite but one example, Avista's Information and Technology
16 businesses lost \$.19 per share and Avista Ventures lost \$.09 per share during
17 the last quarter. This total loss of \$.28 per share exceeded Avista Utilities'
18 quarterly earnings of \$.20 per share. Nor were these losses a one-time
19 phenomenon. Avista Information and Technology and Avista Ventures both had
20 comparable losses in 2000 as well. Given the fact that Avista is arguing that
21 emergency action is necessary to meet cash flow deficiencies and protect its

1 bond ratings, the unregulated companies' financial results become a relevant
2 issue.

3 Finally, the Commission should also be apprised of Avista's efforts, if any,
4 to recover a portion of its high priced purchases in the pending Northwest refund
5 hearings before the FERC, and Avista should be required to justify any positions
6 it has taken in that proceeding.

7 Q. ARE THERE ANY OTHER RELEVANT MATTERS YOU WOULD LIKE TO
8 BRING TO THE COMMISSION'S ATTENTION?

9 A. Yes. Avista's deferral balances attributable to Idaho electric operations are only
10 about 15% of its total deferrals as of June 30, 2001. Avista clearly needs the
11 vast majority of its requested rate relief from other jurisdictions, and if that relief is
12 not forthcoming it is doubtful whether Idaho rate increases would be sufficient to
13 avoid the end of the year financial problems Avista is forecasting. I mention this
14 obvious fact only in order to point out that the Idaho Commission should carefully
15 follow the companion proceedings in Washington, which will have a
16 disproportionate impact on Avista's financial situation.

17 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

18 A. The Commission should grant Avista's request for a net rate increase of up to
19 14.7%, but only for a limited period of time, and subject to refund after a full
20 prudence review is conducted. This review should be scheduled and completed
21 as soon as possible for the protection of both Avista and the ratepayers.

22 Coincidentally, this recommendation is apparently very similar to the reported

1 recommendations of the WUTC staff, which were filed in Avista's companion
2 case in Washington as this testimony was being finalized.

3 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

4 A. Yes.

BEFORE THE IDAHO PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION)
BY AVISTA CORPORATION FOR A PCA) CASE NO. AVU-E-01-11
SURCHARGE IN ELECTRIC RATES)

DIRECT TESTIMONY

OF

DENNIS E. PESEAU

ON BEHALF OF

POTLATCH CORPORATION