Q. Please state your name and business address for the record.

A. My name is Keith D. Hessing and my business address is 472 West Washington Street, Boise, Idaho.

Q. By whom are you employed and in what capacity?

A. I am employed by the Idaho Public Utilities Commission as a Public Utilities Engineer.

Q. What is your educational and experience background?

A. I am a Registered Professional Engineer in the State of Idaho. I received a Bachelor of Science Degree in Civil Engineering from the University of Idaho in 1974. Since then, I have worked six years with the Idaho Department of Water Resources, and two years with Morrison-Knudsen. I have been continuously employed at the Commission since August 1983.

As a member of the Commission Staff, my primary areas of responsibility have been electric utility power supply, revenue allocation and rate design.

Q. What is the purpose of your testimony in this proceeding?

A. This is Avista’s first PCA filing since its PCA methodology was changed effective January of this year. I review the application of the methodology and, using Exhibit No. 101, I categorize and quantify the actual PCA costs deferred through the first 6 months of 2001. I comment on the Company's proposal to project PCA deferrals and review the proposed rate design.

Q. Would you please summarize your testimony?

A. After reviewing the recently revised PCA methodology employed by the Company to obtain actual PCA deferrals, I conclude that the Company has applied the methodology approved by the Commission. I briefly examine expected PCA rate adjustment scenarios with and without projected PCA deferrals and conclude that rates will be more stable when projected PCA deferrals are included. I discuss the true up that occurs between actual PCA deferrals and actual PCA revenues at the end of 2003. I review the Company's proposed rate design and agree that it is consistent with Commission approved methodology and that the Company calculated rates are the rates that the Commission should put in place.

PCA METHODOLOGY

Q. Are the PCA methodologies used by the Company to quantify and defer power supply costs for the period October 2000 through June 2001 methodologies approved by the Commission?

A. Yes. This time period includes two PCA methodologies approved by the Commission. The methodology for October through December 2000 was last approved in Case No. AVU-E-00-6, Order No. 28616. This case modified previously existing PCA methodology.

The PCA methodology applied beginning January 2001 was approved in Case No. AVU-E-01-1, Order No. 28775. The final order in that case approved very substantial modifications to the previously existing PCA methodology.

Q. Have you prepared an exhibit that shows the impact on the PCA deferral balance of each PCA component separately?

A. Yes, I have. Staff Exhibit No. 101 shows individual component impacts on PCA deferrals as proposed by the Company. These will be discussed in greater detail in the testimony that follows.

Q. Did you review the Company's calculations for the October through December of 2000 time period?

A. Yes.

Q. What was the balance carried forward into the 2001 time period?

A. The PCA for that time period accumulated a deferred credit or refund to ratepayers of $3,341,000. This is shown on Line 1 of Exhibit No. 101.

Q. What have PCA deferrals been during the first six months of 2001?

A. The Company’s calculations indicate that PCA deferrals for the first six months of 2001 are $33,348,057 to be surcharged to customers. This is shown on Line 13 of Exhibit No. 101. The 2000 – 2001 net PCA deferral balance at the end of June 2001 was $30,007,057 which the Company proposes to surcharge to customers. This balance is shown on Line 14.

Q. What are the components of the PCA methodology that became effective January 2001?

A. The components of the modified methodology were defined in Case No. AVU-E-01-1 and enumerated in Order No. 28775. The 2001 PCA methodology is based on the difference between actual and authorized power supply costs. Actual account balances are now used instead of computer modeled account balances. In general the power supply cost difference is calculated for Account 501 – Thermal Fuel, Account 547 – Combustion Turbine Fuel, Account 555 – Purchased Power and Account 447 – Sales for Resale. The cost differences are accumulated for each month, Idaho’s jurisdictional share is determined and 90 percent of that amount is deferred in the PCA for recovery or rebate at a later time.

Q. What are the approximate Idaho PCA deferral amounts associated with these accounts in the first 6 months of 2001?

A. The Purchased Power deferral is $114 million to surcharge, the thermal fuel deferral is $2 million to rebate, the CT fuel deferral is $13 million to surcharge and the Sales for Resale deferral is $86 million to rebate. These net to a surcharge of approximately $39 million dollars.

Q. Exhibit 101, Line 2 shows that actual purchased power costs are significantly above normal or authorized levels. Is this due to the change in PCA methodology?

A. No. Low water levels lead to reduced generation from the Company’s hydro power generation facilities causing the Company to purchase more power on the market to meet its loads. This coupled with extremely high market prices result in much higher than normal purchased power costs.

Q. Exhibit 101, Line 5 shows that actual Sales for Resale revenues are significantly above normal or authorized levels. What would cause this?

A. Sales for resale revenues are up significantly from normalized levels. Sales for Resale dollar amounts are approximately 76% of purchased power costs, $288 million more than normalized base levels. This appears to be a very large increase in Sales for Resale revenues during a time period when the Company is short on resources and purchasing energy to meet native load requirements. Staff will continue to review the load/resource situation of the Company for the January through June 2001 period as this case proceeds. Severe time constraints have prevented Staff from being able to fully answer this question at this time. Based on my review to date, I have no reason to believe that there is a problem.

Q. What adjustments to PCA deferral account balances were approved when the Commission last modified the PCA methodology?

A. The approved adjustments to PCA methodology that are contained in the previously cited order are (1) an Idaho Retail Revenue Adjustment, (2) a Centralia Capital and Operation and Maintenance Credit, (3) a PGE Capacity Revenue True up, and (4) accumulated interest during the deferral period.

Q. Are there other costs in the PCA deferral balance that the Commission has approved for recovery?

A. Yes. The Commission has approved PCA deferral treatment for three separate Avista energy buy-back programs. These programs are discussed in more detail in Staff witness Stockton's testimony.

NORTHEAST CT EMMISSIONS EXPENSE

Q. Is the Company requesting PCA recovery of other costs not previously approved by the Commission?

A. Yes. In this filing the Company is requesting recovery of emissions-related expenses associated with increasing the allowable operating hours for the Northeast combustion turbine. When market price is higher than the variable operating cost of the turbine, PCA deferrals are reduced because power purchases are reduced, or fuel costs are reduced, or secondary sales revenues are increased or any combination of the three. To the extent that the Company economically operated the Northeast CT during hours that it could not have otherwise operated, these benefits are captured in the appropriate power supply accounts. Staff witness Stockton further discusses the treatment of these costs in her testimony.

IDAHO RETAIL REVENUE ADJUSTMENT

Q. The Company has included an "Idaho Retail Revenue Adjustment" in it's PCA deferral calculations. Is this part of the approved PCA methodology?

A. Yes. In Case No. AVU-E-01-1 the Commission issued Order No. 28775 directing the Company to include this adjustment in its revised PCA calculations. The adjustment is included in recognition of the fact that when retail load grows power supply costs increase, all else being equal. The increased power supply costs are captured in the difference between the actual and authorized power supply account balances and thus in the PCA deferral.

The Company also recovers power supply costs in retail rates charged to new customers. In the case of retail load growth, the 2.123 ¢/kWh credit applied to the load growth reduces the PCA deferral, which is designed to prevent the double recovery of power supply costs by the Company. If retail load decreases, the revenue adjustment calculation increases PCA costs which, the Company contends, partially compensate it for lost revenues.

CENTRALIA CAPITAL AND O&M CREDIT

Q. The Company has included a “Centralia Capital and O & M Credit” in its PCA deferral calculations. Is this part of the approved PCA Methodology?

A. Yes. When the Commission revised the Company’s PCA methodology with Order No. 28775 issued in Case No. AVU-E-01-1, it directed the Company to include this adjustment. The adjustment reflects the reality that Avista’s base rates, set in its last general rate case, include Centralia as a resource. In May of 2000 Avista's interest in the plant was sold and a replacement power contract was entered into. Actual power supply costs without Centralia and with the replacement contract are reflected in the actual power supply accounts used to calculate the monthly PCA deferral. Base rates reflect the Centralia capital costs such as return on investment and Centralia operation and maintenance costs. In order to be consistent, base rates need to be adjusted to reflect current conditions. The Centralia credit is designed to offset the Centralia Revenue requirement that is still part of base rates. The Centralia credit should not be subject to 90/10 sharing.

Q. What does a review of the PCA deferrals tabulated in Exhibit No. 101 show?

A. A review of the deferrals shows that most of the money has accumulated in the power supply expense accounts with net adjustments reducing the deferral balance. The net of deferrals for purchases and sales is approximately $28 million to surcharge. Increased fuel costs from the two fuel cost accounts represent approximately $11 million dollars in Idaho surcharge deferrals. These deferral amounts are consistent with above normal market purchases during drought conditions when market prices were 10 times those used to calculate base rates. In general this was the situation that existed through most of the deferral period.

POWER COST PROJECTION

Q. Does the Company's proposed rate increase include recovery of PCA amounts expected to be deferred after June of 2001?

A. Yes, it does. The Company proposes to project PCA deferrals for the period July 2001 through December 2003.

Q. What are the PCA deferral amounts projected by Avista?

A. For the period July through December of 2001, Avista projects PCA surcharge deferrals of approximately $37.2 million with surcharge interest of approximately $1.6 million. For the 2002 calendar year Avista projects PCA rebate deferrals of approximately 0.75 million with surcharge interest of approximately $4.3 million. For the 2003 calendar year Avista projects PCA surcharge deferrals of approximately $11.3 million and surcharge interest of approximately $4.8 million. The amount of the Company's projected surcharge including interest is approximately $58.5

million.

Q. Briefly describe the assumptions used by the Company in its projection.

A. The Company projects that water conditions will gradually return to near normal by the end of 2003 and that market prices will fall from $75.77/MWh to $41.75/MWh for a flat product by the end of 2003. The Company's projection also includes expected resource additions and power supply contract expirations.

Q. What is your opinion of the Company's projection?

A. It is a projection based on a number of assumptions. As such, it will not be completely accurate. The two big assumptions are assumptions about market prices and stream flows. I believe that the Company's projection is reasonable based on the information that was available at the time of the projection. I also believe that it is reasonable for the Commission to use this information in establishing PCA rates in this case as long as differences between PCA revenues and PCA deferrals are trued-up. The true up is discussed later in this testimony.

PGE CREDIT

Q. What else, other than actual and projected PCA deferrals, is included in the Company's rate proposal?

A. The Company is proposing to include a 15-month amortization of a PGE credit that reduces the surcharge deferral. Staff witness Stockton discusses the deferral in more detail in her testimony.

RECOVERY ALTERNATIVES

Q. The projected PCA deferral is larger than the actual deferral. Is there a customer advantage to approving a PCA rate increase that includes larger projected costs than actual costs?

A. If the projections are relatively accurate, it could provide a relatively stable PCA rate for the 27-month period.

Q. What if the projections prove to be inaccurate?

A. If the projections prove to be significantly inaccurate, the Company proposes to file to adjust rates during the 27-month period. It is Staff's proposal that the Company make annual formal filings including actual PCA deferrals and recommendations on whether rates should be modified. This provides the opportunity for a formal review and makes detailed information concerning PCA deferrals and their recovery available to all interested parties.

Q. What happens at the end of the 27-month period?

A. At the end of 2003, regardless of whether there have been mid-period rate adjustments, there will be a difference between the actual PCA deferrals under the approved methodology and PCA costs recovered through the applied rates. This difference will be determined and placed back in the deferral account for future surcharge or rebate. In other words the difference between actual PCA deferrals and rates put in place to recover them will be trued-up.

Q. Is it possible to design PCA rates without including projected deferrals?

A. Yes, it is. Company witness Falkner discusses what the resulting increase would be if rates were put in place for one year based on actual PCA deferrals through June of 2001. He indicates that the rate increase would be 20%. (Falkner, Page 4)

Q. Is it possible to exclude the projection and not increase annual rates more than the Company has proposed?

A. It may be. The application of an appropriate amount of the PGE credit along with actual PCA cost deferrals may allow rates for one year that do not exceed those proposed by the Company.

Q. What would be the result of applying approved PCA methodology after rates were put in place to recover deferrals through June of 2001?

A. If the Company's projections are anywhere near correct, the surcharge trigger, currently set at $3 million, would be exceeded monthly and the Company would apply for additional PCA surcharges or carry the amounts forward with interest in the deferral account. Amounts carried forward would have to be surcharged later if they were not offset by future rebate deferrals. Carrying significant surcharge amounts in the deferral account would negatively impact the Company's cash flow and ability to borrow.

Q. Other than the proposed deferral methodology, does the Company propose a PCA methodology in this case which departs substantially from Commission approved methodology?

A. Yes. The Company proposes to do three things that depart from approved PCA methodology. First, the Company proposes to "project" PCA deferrals. This is not without precedent. Idaho Power "forecasts" power supply costs, however, Idaho Power's forecast is more limited in scope than Avista's projection.

Second, Avista proposes to ignore the PCA trigger which is currently set at $3 million with a maximum surcharge or rebate of $12 million in place at any one time. However, the approved methodology does allow the Commission to waive the $12 million ceiling if necessary.

Finally, the Company proposes to offset the PCA surcharge amount with a PGE contract credit. This is unprecedented in the history of Avista's PCA.

Q. Why should the Commission consider the Company's rate proposal?

A. The Company appears to have forsaken a portion of the approved methodology for a situation specific practical approach. The Company's approach levelizes PCA rates over what otherwise could be a very volatile period and meets lenders requirements so that Avista can obtain necessary loans for short term financing and long term financing of capital assets.

Q. Does the Staff support the PCA deferral recovery methodology proposed by the Company?

A. Yes, with the true up to actual that occurs at the end of 2003 and with the annual reviews and possible mid-course rate adjustments previously discussed.

RATE DESIGN

Q. How does the Company propose to design rates?

A. The Company proposes to assign the annual revenue requirement associated with the surcharge to each customer class on an equal percentage basis. Within each class the increase would be recovered by increasing the energy rate except in the lighting class where the increase would be a uniform percentage increase to the monthly lighting rates.

Q. Is this rate design methodology consistent with currently approved PCA rate design methodology?

A. Yes, it is.

Q. You mentioned earlier in your testimony that PCA revenues are trued-up with actual deferrals over the 27-month recovery period. How is that done?

A. At the end of each month actual PCA deferrals are calculated by applying the approved PCA methodology. Also at the end of each month revenues from the PCA rates in place during the month are calculated. For non-lighting classes, the number of actual kWh sold in the month are known and the ¢/kWh PCA rate is known. This allows the calculation of the actual PCA revenue received by the Company for each class. For the lighting class, actual revenues received are known and the percentage of those revenues associated with the PCA is known. This allows the calculation of actual PCA revenues received from the lighting class. The lighting and non-lighting PCA revenues are compared to actual PCA deferrals on a monthly basis. At the end of the recovery period any under or over recovery can be determined and trued-up as previously discussed.

Q. In the most recent Idaho Power Company PCA surcharge case a large rate increase was passed on to customers. The Commission implemented a three tiered inverted block energy rate structure for the residential class. What is Avista's proposal for residential rate design?

A. Avista's Residential base rates currently include a two tier inverted energy block rate structure.

The Company's proposed rate design increases rates in each block by an equal percentage amount such that class revenues increase by the proposed 19.4%. So doing maintains the inverted block structure. The energy rate for the first 600 kWh becomes 5.507 ¢/kWh and the energy rate for all other kWh's becomes 6.408 ¢/kWh. Maintaining the inverted block rate structure continues to send price signals to residential customers that encourage conservation.

Q. Does the Company currently have PCA rates in effect?

A. Yes, it does. Commission Order No. 28627 issued in Case No. AVU-E-00-9 allowed the Company to increase rates by 4.8% to recover approximately $5.7 million from Avista's Idaho customers. These rates were put in place for a one-year period beginning February 1, 2001.

Q. In this rate request, how does Avista propose to treat these existing PCA rates?

A. Avista proposes that the existing PCA rates not expire at the end of January 2002 as scheduled, but be continued through the end of 2003. The Company has incorporated the impact of doing this in the rates that it is proposing in this case.

Q. Does the Staff support the Company's proposal?

A. Yes. It is part of the Company's package designed to recover the needed revenues through relatively stable rates over the 27-month recovery period.

Q. Does the Staff agree that the Company proposed rate design is acceptable?

A. Yes.

Q. The Company proposes that the new rates become effective September 15, 2001. Does Staff agree that this should be the effective date?

A. Yes.

Q. Does this conclude your direct testimony in this proceeding?

A. Yes, it does.