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IDAHO PUBLIC
UTILITIES COMMISSION

AVISTA Corp.

September 25, 2003

State of Idaho
Idaho Public Utilities Commission
Statehouse
Boise, ID 83720

Attention: Ms. Jean D. Jewell, Commission Secretary

RE: Case No. AVU-E-02-08

Enclosed for filing with the Commission is an original and nine copies of the testimony of Mr. Kelly Norwood, in the Case referenced above. Mr. Norwood's testimony provides additional information in support of the Joint Petition of Avista and Potlatch Corporation dated August 22,2003, which requests approval Power Purchase and Sale Agreement between the two companies. Related to this matter, the two companies have also executed a Generation Interconnection Agreement, which will be provided to the Commission.

If you have any questions regarding this filing, please call Kelly Norwood at 509-495-4267 or Brian Hirschkorn at 509-495-4723.

Sincerely,

Kelly Norwood

Kelly Norwood
Vice-President, Rates and Regulation

Enc.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 25th day of September 2003, I caused to be served a true and correct copy of the foregoing by the method indicated below, and addressed to the following:

Ms. Jean Jewell, Secretary
Idaho Public Utilities Commission
472 West Washington Street
PO Box 83720
Boise, Idaho 83720-0074

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Patty Olsness

Patty Olsness, Avista Utilities

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ATTORNEYS FOR AVISTA CORPORATION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

POTLATCH CORPORATION *Complainant* v. AVISTA UTILITIES, *Respondent*	)	CASE NO. AVU-E-02-08 DIRECT TESTIMONY OF KELLY O. NORWOOD

Q. Please state your name, business address and present position with Avista Corporation?

A. My name is Kelly O. Norwood and my business address is 1411 East Mission Avenue, Spokane, Washington. My present position is Vice-President of State and Federal Regulation.

Q. Would you describe your educational background and professional experience?

A. I am a graduate of Eastern Washington University with a Bachelor of Arts Degree in Business Administration, majoring in Accounting. I joined the Company in June 1981. Over the past 22 years, I have spent approximately eleven years in the Rates Department with involvement in cost of service, rate design and revenue requirements. I have spent approximately eleven years in the Energy Resources Department (power supply and natural gas supply) in a variety of roles with involvement in resource planning, system operations, resource analysis, negotiation of power contracts and risk management. I was appointed Vice-President of State and Federal Regulation in March 2001.

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

A. My testimony in this proceeding will describe the essential terms of the proposed Power Purchase and Sale Agreement (Agreement) between Avista (Company) and Potlatch. I will also describe the proposed regulatory/accounting treatment of the Agreement, as well as the estimated revenue requirement effects of this proposal.

Q. Would Commission approval of the Agreement result in a settlement of Case No. AVU-E-02-08, a complaint filed by Potlatch against Avista regarding Avista's purchase of Potlatch's generation?

A. Yes it would.

Q. Would you please describe the electric service provided to Potlatch by Avista in the past, as well as the disposition of Potlatch's generation.

A. Yes. Prior to January 1, 1992, Potlatch utilized its generation to serve a substantial portion of its load requirements, with the balance of its load requirements served by Avista under tariff Schedule 25. From January 1, 1992 through December 31, 2001, Avista purchased 55 average megawatts of Potlatch's generation and served essentially all of Potlatch's load requirements under a special contract. The rates, terms and conditions for power purchases and sales under the contract were negotiated between the Parties and approved by the Commission in Order No. 23858 in Case No. WWP-E-91-5. As part of that Case, Avista proposed, and the Commission approved, special regulatory/accounting treatment of the contract, due in part to the size of the load and the unique nature of the contract.

Avista and Potlatch agreed, in a Joint Motion dated August 17, 2001, filed in Case No. AVU-E-01-5, that upon expiration of the special contract on December 31, 2001, Potlatch's load would be served at Schedule 25 rates. From January 1, 2002 through June 30, 2003, Potlatch used its approximate 60 average megawatts of generation to reduce its load requirements while purchasing the remainder (approximately 40 average megawatts) from Avista.

Q. Please describe the essential terms of the proposed Agreement.

A. The essential terms of the proposed Agreement are as follows:

Term of Agreement (Section 3 of Agreement)

The Agreement is for a ten-year term, beginning July 1, 2003 and ending June 30, 2013. The Agreement is conditioned upon approval by this Commission of:

1) the Agreement,

2) direct assignment of all Power Purchase costs paid by Avista to Potlatch to Avista's Idaho Operations, and

3) deferral and recovery of 100% of all Power Purchase costs paid by Avista to Potlatch through Avista's Idaho Power Cost Adjustment (PCA) or otherwise recovered through base retail rates.

In the event the Agreement is not finally approved by this Commission by December 31, 2003, the Agreement shall be terminated and subject to a "True-Up Process," which provides for a refund of amounts paid under the Agreement to reflect revenues and expenses that would have been incurred by both Parties absent the Agreement.

Avista Purchase of Potlatch Generation (Section 4 of Agreement)

Avista will be the sole purchaser of Potlatch's generation. Avista will pay Potlatch $42.92 per megawatt-hour for up to 543,120 megawatt-hours (544,608 during a leap year) generated by Potlatch during each July 1 through June 30 period ("Operating Year") of the Agreement. This amount is equivalent to 62 average megawatts and is referred to in the Agreement as the "Base Generation Amount." This Base Generation is illustrated in the graph attached as Exhibit No. 1.

Amounts generated by Potlatch in excess of the Base Generation Amount each Operating Year ("Excess Generation Amounts") will either be purchased by Avista at 85% of the applicable Mid-Columbia firm index price, with a price cap of $55 per megawatt-hour, or used by Potlatch to reduce its load requirements from Avista. The purchase of Potlatch's Excess Generation Amounts by Avista is limited to 43,800 megawatt-hours (5 average megawatts) each Operating Year; Excess Generation Amounts above this level would be used by Potlatch to serve its load requirements. The disposition of Potlatch's Excess Generation Amounts up to 43,800 megawatt-hours will be at Potlatch's election each Operating Year, subject to the notification provisions in Section 4 (c) of the Agreement.

Additionally, Potlatch has the capacity to generate additional amounts ("Incremental Generation Amounts") under certain circumstances. The Agreement provides for the purchase by Avista of Incremental Generation Amounts when it is mutually beneficial to both parties, as set forth in Section 4 (e) through (h) of the Agreement.

The Base, Excess and Incremental Generation Amounts, as described above, are illustrated on Exhibit 1. As shown on Exhibit 1, Potlatch's Base Generation amount will vary from hour to hour, however, it is limited to 543,120 megawatt-hours per year. The illustration also shows an example of Excess Generation Amounts, assuming Potlatch's generation exceeds the Base Generation Amount during an Operating Year. Also shown are examples of Incremental Generation Amounts, which can occur at any time by mutual agreement between the parties.

Avista Sale of Power to Potlatch (Section 5 of Agreement)

Avista will serve Potlatch's load requirements at Potlatch's Lewiston Plant under its Extra Large General Service Schedule 25 rates, including the present Power Cost Adjustment (PCA) surcharge and all other applicable rate adjustments, unless the Commission issues an order in the future authorizing different billing rates. Nothing in the Agreement prejudices either Party's right to propose, or the Commission to order in future rate proceedings, that Avista's service to Potlatch should be priced at rates other than Schedule 25.

Q. Would you please explain the derivation of the $42.92, which is the proposed payment for Potlatch's Base Generation Amount (up to 62 average megawatts)?

A. Yes. The proposed $42.92 per megawatt-hour payment is Avista's estimated 10-year levelized avoided cost contained in its most recent Integrated Resource Plan (IRP), filed with the Commission in May 2003.

Q. Has the Commission Staff reviewed this IRP filing?

A. Yes. In the Commission Staff's written comments it recommended Commission acceptance of the Company's IRP filing, and the Commission accepted the IRP filing on August 29, 2003.

Q. How does the power purchase rate of $42.92 compare to the most recent administratively determined avoided cost rates ordered by this Commission for cogeneration projects less than 10 megawatts?

A. The comparable rate ordered by the Commission in Case No. GNR-E-02-1 for projects less than 10 megawatts is $44.43 per megawatt-hour.

Q. Do you believe that $42.92 per megawatt-hour is a reasonable amount to pay for Potlatch's Base Generation, given the other terms and conditions contained in the Agreement?

A. Yes. The proposed Agreement represents negotiated terms and conditions that both Parties believe are fair and reasonable. The $42.92 amount is a recently determined avoided cost and is supported by all of the analysis behind the development of Avista's IRP. The other terms and conditions contained in the Agreement represent a balancing of the interests of the Parties.

Q. Would you explain how the other terms and conditions contained in the Agreement balance the interests of Potlatch and Avista, as well as Avista's other retail customers?

A. Yes. The Agreement provides Potlatch with operating flexibility for its generating units, as well as the opportunity to generate additional amounts to the mutual benefit of Potlatch and Avista's other Idaho customers. The Agreement provides Avista with a reasonable level of certainty regarding Potlatch's load requirements for the ten-year term of the Agreement. With regard to the operating flexibility afforded Potlatch, Potlatch's generation level has historically been relatively constant and predictable. However, the level can vary from hour-to-hour and is "unit-contingent," i.e., subject to unscheduled outage or maintenance on one or more of its generating units.

Additionally, the Agreement provides the opportunity for Potlatch to generate additional amounts, referred to in the Agreement as Incremental Generation Amounts, when it makes economic sense for both Parties. Potlatch has additional generation capacity over and above its Base Generation level of approximately 60 megawatts.

Potlatch has agreed to make this generation available to Avista when economic conditions are favorable. The benefits from the Incremental Generation Amounts would accrue to Potlatch and Avista's other Idaho customers.

Q. You stated that, "The Agreement provides Avista with a reasonable level of certainty regarding Potlatch's load requirements for the term of the Agreement." Why is this important?

A. Avista will be the sole purchaser of Potlatch's generation during the term of the Agreement. Absent an agreement between the two companies, Potlatch, for example, could sell its generation output to a third party when it made economic sense to do so, i.e., when it could net more from a sale to a third party than to use the generation to reduce its own load requirements. A sale to a third party could be long-term or short-term, but could occur anytime when market prices rise to a level that exceeds Avista's Schedule 25 rates. If Potlatch sells its generation to a third-party, its load requirements from Avista would increase by the amount of generation it sells, i.e., approximately 60 average megawatts. Under a high wholesale market price scenario, this could result in significant cost exposure to Avista's other retail customers. For example, if electric wholesale prices escalated to $100 per megawatt-hour, Potlatch would sell its generation to a third party rather than generate into its own load, which would cause Potlatch's net load requirements from Avista to immediately rise from approximately 40 average megawatts to 100 average megawatts. This could require Avista to purchase an additional 60 average megawatts at these high wholesale market prices to serve the additional 60 net average megawatts of Potlatch load, resulting in a substantial increase in costs to Avista's other customers.

Q. Could you please explain the provisions contained in Section 3 of the Agreement regarding the accounting/regulatory treatment of the power purchase costs associated with Avista's purchase of Potlatch's generation?

A. Yes. The provisions state that the costs associated with the purchase of Potlatch's generation will be directly assigned to the Company's Idaho operations and be deferred in its entirety (100%) and recovered through the present Power Cost Adjustment (PCA) mechanism, or otherwise recovered through base retail rates.

Q. Could you please summarize the estimated effects, as well as the timing of these effects, on Avista's other customers that would result from Commission approval of the Agreement?

A. Yes. The change in the PCA deferral balance resulting from the proposed Agreement, as compared to the costs currently included in base retail rates, would be an annual reduction (benefit) of approximately $1.2 million, until such time as the present surcharge expires or the present surcharge rates change. This net benefit is comprised of: 1) Potlatch's contribution of $5.3 million annually based on the present surcharge in effect included in Schedule 25 rates, and 2) the $4.1 million net cost of the new Agreement.

The Company's next general rate filing would reflect an additional revenue requirement of $4.1 million, or approximately a 2.3% rate increase, representing the change in base tariff rates for all Idaho customers. The $4.1 million revenue requirement essentially represents a "permanent" rate change for Idaho customers for the term of the Agreement, while the PCA surcharge paid by Potlatch (presently $5.3 million per year) is a temporary benefit to customers as long as the present surcharge level remains in effect.

Q. Why do the Parties believe it is appropriate to directly assign the purchased power costs associated with Potlatch's generation to Idaho?

A. There are several compelling reasons for the Parties' allocation proposal. The first, and perhaps the most important, is that the proposal properly matches the jurisdictional changes in revenues and expenses that are produced by the Agreement. When Potlatch ceased generating into its own load on July 1, 2003, Avista's Idaho PCA surcharge revenues automatically increased by approximately $5.3 million per year. Even after the deduction of the $4.1 million in increased costs for purchases from Potlatch, the net effect is an immediate reduction of $1.2 million annually in the deferred costs in the Idaho PCA. If the Agreement's costs are not directly assigned to Idaho, Avista's Washington customers would be asked to shoulder roughly two-thirds of the costs, but they would get none of the benefits from the increased Potlatch revenues.

Idaho is also the primary beneficiary of what I will characterize as the "secondary" benefits of the Agreement. To the extent this Agreement helps to insure Potlatch's continued operation in Idaho, the benefits from continued employment, a bolstered tax base, and economic spin-off benefits for other businesses flow primarily, and in some cases exclusively, to Idaho and its citizens.

In addition, it is important to note that this Agreement represents the settlement of issues before the Idaho Commission and Idaho courts. In many respects, this is an Idaho solution to an Idaho "problem." In crafting this Agreement, the Parties also looked to the Idaho Commission's policies on PURPA issues. Under these circumstances, it is both fair and reasonable for Idaho to accept both the benefits and the detriments of an Agreement driven primarily by Idaho law and public policy.

As the Commission may be aware, the Washington Utilities and Transporation Commission takes a much different view of PURPA purchases, and this Agreement contains a number of provisions that may not be supported in the Washington jurisdiction. Consequently the WUTC may not accept the ratemaking consequences of this Agreement, and this is especially true where Washington would be asked to shoulder most of the costs of the Potlatch purchases, but receive none of the benefits from the increased sales to Potlatch. Without the direct assignment of revenues and expenses to Idaho, the result of the Agreement would be an additional annual revenue requirement of approximately $6.8 million in Washington. I believe this result would not be viewed favorably by the Washington Commission.

This Agreement eliminates potential inter-jurisdictional disputes, and will make it much easier for the Idaho Commission to exercise plenary jurisdiction over one of the state's largest electric customer without possible conflicts with its Washington counterpart.

Q. You stated earlier that the near term impact of the Agreement will decrease Idaho deferred PCA cost by $1.2 million per year. What would be the estimated long term effect on the Company's Idaho customers from the Agreement?

A. Without taking into account the current PCA surcharge revenues being paid by Potlatch, the result to the Company's Idaho operations is an increased revenue requirement of approximately $4.1 million per year, or approximately 2.3% of current retail revenue. This $4.1 million amount is the difference between the amount that is included in the Company's present base tariff rates, which reflects the prior purchase and sale agreement between the Company and Potlatch, and the effect of the proposed Agreement (power purchase cost less Schedule 25 base tariff revenue).

Over time, however, to the extent that Avista's overall costs rise, e.g., through general rate case increases, the negative impact of the Potlatch contract will decrease. This is the nature of a purchased power contract with a levelized price, which remains fixed as other power costs increase.

Finally, we should not ignore the potential benefits Idaho customers could receive from the purchase of occasional Incremental Generation Amounts from Potlatch. These benefits, which would also be directly assigned to Idaho, would also mitigate a portion of the negative impact on Idaho customers.

Q. Is the Company requesting a rate increase in this proceeding?

A. No. As I stated earlier, the immediate impact of the Agreement will be positive for Idaho ratepayers through a reduction in the PCA deferral balance. Any change in base retail rates related to this Agreement would be addressed in the Company's next general filing. Until such time as a general rate change is approved by the Commission, the $4.1 million would be deferred through the PCA mechanism for future recovery together with the PCA surcharge revenues received from Potlatch.

Q. The Company is proposing that 100% of the costs associated with the purchase of Potlatch's generation be deferred through the PCA. Has this Commission approved recovery of 100% of PURPA generation purchases for deferral by other electric utilities it regulates?

A. Yes. It is my understanding that the Commission has approved 100% deferral of the costs associated with some PURPA purchases by Idaho Power. The generators owned by Potlatch are Qualifying Facilities (QFs) under PURPA, and the purchase of Potlatch's generation by Avista satisfies any obligation that Avista may have to purchase power from Potlatch under PURPA. The magnitude of the purchase is an additional factor underlying the Company's request.

In addition, through this filing, Avista and Potlatch are requesting specific review and approval of the Agreement, as well as the ratemaking treatment of the Agreement. Therefore, following review of the Agreement through this proceeding, if the Agreement is approved we believe it is appropriate to provide 100% recovery of the costs.

Q. Would you please summarize your testimony?

A. Yes. The Company and Potlatch request approval of the proposed Power Purchase and Sale Agreement between the Parties. The Agreement provides for the purchase by Avista of Potlatch's Base Generation up to 62 average megawatts each year at $42.92 per megawatt-hour. The Agreement also provides for the purchase of Excess and Incremental Generation Amounts under the terms and conditions set forth in the Agreement. Avista will serve Potlatch's load requirement of approximately 100 average megawatts under Schedule 25 rates, unless the Commission issues an order authorizing different billing rates.

The Company also requests that the Commission approve the direct assignment of the costs associated with the purchase of Potlatch's generation to the Company's Idaho operations, as well as inclusion of 100% of the costs in the PCA deferral balance until the costs are otherwise recovered through base retail rates.

During the duration of the present PCA surcharge, direct assignment of the power purchase cost to Idaho would be flowed through the Company's PCA and would produce a net annual benefit to customers of about $1.2 million when combined with the PCA surcharge revenue received from Potlatch under Schedule 25 rates. Following expiration of the surcharge, under the present Schedule 25 rates, the Agreement would result in an annual revenue requirement of $4.1 million, or the equivalent of a 2.3% rate increase. However, to the extent that future general rate increase requests are spread to Schedule 25, and to Potlatch's load, it would have a mitigating effect on the costs borne by other Idaho retail customers.

Q. Does that conclude your prepared testimony?

A. Yes it does.

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

CASE NO. AVU-E-02-08

EXHIBIT NO.___ (KON-1)

Exhibit 1 - Avista-Potlatch Contract