RECEIVED

2009 JAN 23 PM 12:43

IDAHO PUBLIC
UTILITIES COMMISSION

DAVID J. MEYER
VICE PRESIDENT AND CHIEF COUNSEL OF
REGULATORY & GOVERNMENTAL AFFAIRS
AVISTA CORPORATION
P.O. BOX 3727
1411 EAST MISSION AVENUE
SPOKANE, WASHINGTON 99220-3727
TELEPHONE:(509) 495-4316
FACSIMILE:(509) 495-8851

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION FOR THE AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC AND NATURAL GAS SERVICE TO ELECTRIC AND NATURAL GAS CUSTOMERS IN THE STATE OF IDAHO)	CASE NO. AVU-E-09-01 CASE NO. AVU-G-09-01 DIRECT TESTIMONY OF DAVE B. DEFELICE

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

I. INTRODUCTION

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

A. My name is Dave B. DeFelice. I am employed by Avista Corporation as a Senior Business Analyst. My business address is 1411 East Mission, Spokane, Washington.

Q. Please briefly describe your education background and professional experience.

A. I graduated from Eastern Washington University in June of 1983 with a Bachelor of Arts Degree in Business Administration majoring in Accounting. I have served in various positions within the Company, including Analyst positions in the Finance Department (Rates Section and Plant Accounting) and in the Marketing/Operations Departments, as well. In 1999, I accepted the Senior Business Analyst position that focuses on economic analysis of various project proposals as well as evaluations and recommendations pertaining to business policies and practices.

Q. As a Senior Business Analyst, what are your responsibilities?

A. As a Senior Business Analyst I am involved in financial analysis of numerous projects within various departments such as Engineering, Operations, Marketing/Sales and Finance.

Q. What is the scope of your testimony?

A. My testimony and exhibits in this proceeding will cover the Company's proposed regulatory treatment of capital investments in utility plant through 2009.

Q. Are you sponsoring any exhibits?

A. Yes. I am sponsoring Exhibit No. 9, Schedule 1 (Capital Expenditures), and Schedule 2 (2009 Capital Additions Detail), which were prepared under my direction.

<u>II. CAPITAL INVESTMENT RECOVERY</u>

Q. What does the Company's request for rate relief include regarding new investment in utility plant to serve customers?

A. In this filing, we are proposing to include in retail rates the costs associated with utility plant that is in-service, and will be used to provide energy service to our customers during the pro forma rate year. This is consistent with prior ratemaking practice in the State of Idaho. The methodology that we use is consistent with the methodology we used in the last general rate cases filed in 2008, Case Nos. AVU-E-08-01 and AVU-G-08-01.

The utility plant investment that we have included in this filing represents utility plant that will be "used and useful" in providing service to customers during the approximate period that new retail rates from this filing will be in effect. The costs associated with the investment will be "known and measurable," and finally, including the costs associated with this investment in retail rates provides a proper "matching" of revenues from customers with the costs associated with providing service to customers (including the cost of utility plant to serve customers).

In the IPUC's Order No. 29602, in Case Nos. AVU-E-04-1 and AVU-G-04-1, dated October 8, 2004, the Commission stated, at page 10, that:

> "Once a test year is selected, adjustments are made to test year accounts and rate base to reflect known and measurable changes so that test year totals accurately reflect anticipated amounts for the future period when rates will be in effect. The Idaho Supreme Court has described "rate base" as "the utility's capital investment amount." *Industrial Customers of Idaho Power v. Idaho PUC* 134 Idaho 285, 291, 1 P.3d 786, 792 (2000). Adjustments to test year accounts generally fall into three categories: 1) normalizing adjustments made for unusual occurrences, like one-time events or extreme weather conditions, so they do not unduly affect the test year; 2) annualizing adjustments made for events that occurred at some point in the test year to average their effect as if they had been in existence during the entire year; and 3) known and measurable adjustments made to include events that occur outside the test year but will continue in the future to affect Company income and expenses."

If utility plant investment that is being used to serve customers is not reflected in retail rates then the retail rates will not be "just, reasonable, and sufficient," i.e., it would not be just or reasonable for customers to receive the benefit provided by the utility investment without paying for it, and the retail rates would not provide revenues "sufficient" to provide recovery of the costs associated with providing service to customers.

Q. Is the Company's application of these ratemaking principles in this filing consistent with prior general rate cases?

A. Yes. In prior cases, the objective has been the same -- to include in retail rates the investment, or rate base, that is providing service to customers, and ensure that there is a proper matching of revenues and expenses during the period that rates are in effect. In Case Nos. AVU-E-08-01 and AVU-G-08-01, the Commission approved including capital investment through December 31, 2008, for rates that were effective October 1, 2008.

Q. How does new investment in utility plant change rate base over time for ratemaking purposes?

A. Historically, the annual dollars spent by the Company on new utility plant were generally relatively close to the level of depreciation expense, with the exception of years where the Company invested in major new utility projects.[1] I will use an example to illustrate, in

---

[1] Recognizing that a portion of the costs associated with capital additions are offset by additional revenues.

general terms, how new investment in utility plant changes rate base over time. Let's assume that the Company's rate base (adjusted net plant in service used to serve customers) at the beginning of Year 1 is $1.5 billion. Also assume that depreciation expense in Year 1 is $80 million, and the Company's new investment in utility plant in Year 1 is also $80 million. During Year 1, rate base increased by $80 million (new investment), and decreased by $80 million (depreciation), and ended up at the same level of $1.5 billion at the end of the year. In this simplified example, the Company's rate base is $1.5 billion, both at the beginning of Year 1, and at the end of Year 1.

For ratemaking purposes, the $1.5 billion of rate base is representative of the level of plant investment used to serve customers, both at the beginning of the year and at the end of the year. Over time, if depreciation expense continues to be approximately equal to new plant investment, rate base would continue at a relatively constant $1.5 billion. Under these circumstances, the use of the $1.5 billion rate base amount from a prior year, i.e., a historical test year, would be adequate for setting rates for the upcoming year (pro forma rate year), because there is little change in the net plant investment used to serve customers.

In a similar manner, in prior general rate cases we have used a rate base amount from a historical test year as the starting point for the pro forma rate year. If there were no major plant additions between the historical test year and the upcoming pro forma rate year, the historical test year rate base amount would be used for the pro forma rate year as being representative of the net plant used to serve customers.

However, if there were known major plant additions that would be in service for the pro forma rate year, such as the addition of Coyote Springs II for Avista, the major transmission upgrades, and the hydroelectric upgrades, then rate base for the pro forma rate year is adjusted for these major investments, so that rate base for the pro forma rate year is representative of the level of investment used to serve customers.

Q. Is Avista's new investment in utility plant exceeding its annual depreciation expense, causing an increase in rate base from the test year to the pro forma rate year?

A. Yes. Avista's investment in plant in 2009 is well above the annual depreciation expense, and will result in an increase in net plant in service (rate base) that will be used to serve customers in the pro forma rate year. Much of this new investment in plant for 2009 is spread among many different utility plant categories, as opposed to a few major plant additions.

Therefore, the Company's pro forma adjustment for new investment in plant in this filing, as in the previous general rate case filing, involves a more detailed analysis of the net change in rate base from the historical test period to the pro forma rate year. The end result, however, is the same in this case as in all prior cases - to reflect in retail rates the level of net plant investment that is used to serve customers during the pro forma rate year, and to have a proper matching of revenues and expenses.

Q. How was rate base for the pro forma rate year developed for this filing?

A. As in prior rate cases, Avista started with rate base for the historical test year, which for this case is the average of monthly averages for the twelve months ended September 30, 2008. Adjustments were made to reflect new additions and accumulated depreciation through December 2009, such that the proposed rate base reflects the net plant in service that will be used to serve customers during the pro forma rate year. Later in my testimony, I will provide the details of the adjustments to rate base.

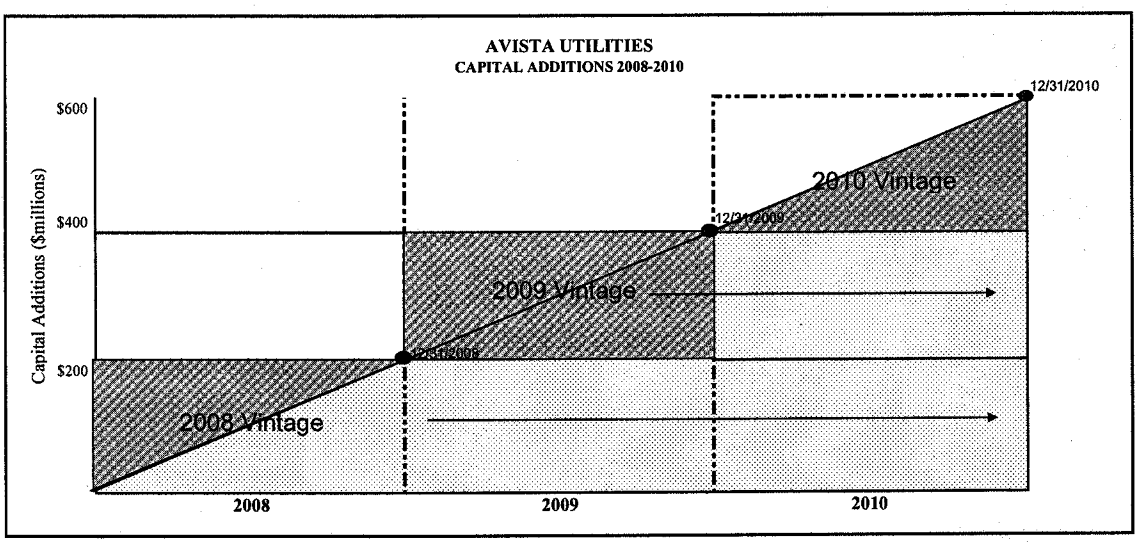
The recent rate case (Case Nos. AVU-E-08-01 and AVU-G-08-01) concluded with new retail rates effective October 1,

2008. As noted earlier, recovery of costs associated with new capital additions through December 31, 2008 was included in retail rates. With regard to the proper "matching" of revenues and expenses, it can be said that <u>some</u> of the new capital through December 31, 2008 was not in place at the time new retail rates went into effect on October 1, 2008. However, it is also true that the costs of new capital already added, and to be added, in 2009 is currently not recovered in retail rates. Although we know that a perfect matching of revenues and expenses would be difficult to achieve, it is very important that, during this period of high capital investment, retail rates reflect the true costs of providing service to customers, in order to afford the Company the opportunity to recover its costs and continue to attract capital under reasonable terms.

With regard to the current filing, Avista is hopeful that new retail rates from this case will be effective by or before mid-2009. Furthermore, new rates from the next general rate case will likely not be effective until sometime well into 2010. December 31, 2009 represents an approximate mid-point of the period in which retail rates would be in place from this case and the next case. Including new capital investment through the mid-point of the "rate year" (approximately mid-2009 through mid-2010) will allow the Company the opportunity to recover the costs associated with capital investment that will serve customers over the course of the rate year.

The following chart illustrates the capital additions for 2008 and 2009 that will be completed and in service through December 31, 2009. Since this case reflects capital additions through only December 31, 2009, during the first part of 2010 (which is the rate year associated with the current case), new capital investment will incurred in order to serve customers, but the costs will not be reflected in the customers' rates.

Illustration 1



Q. You stated earlier that new utility investment in 2008 and 2009 will be substantially higher than the annual depreciation expense. What is driving the significant investment in new utility plant?

A. As we explained in the recent general rate case, the Company is being required to add significant new transmission and distribution facilities, including strengthening the "back bone" of our system, due in part to continued customer growth in our service area, reliability requirements, and capacity upgrades. Other issues driving the need for capital investment include an aging infrastructure, physical degradation, and municipal compliance issues (i.e., street/highway relocations), etc. Company witness Mr. Kinney provides additional testimony on some of these capital requirements.

In addition, although in recent months the rapid increase in the cost of materials (concrete, copper, steel, etc.) has subsided, they are still orders of magnitude higher than what they were even a few years ago, causing the cost of these new facilities to be significantly higher than in the past. Because the cost of adding new facilities is significantly higher than the original cost of existing facilities, the investment in new facilities will be significantly higher than the annual depreciation expense on the existing facilities.

Q. What is causing the substantial increase in raw materials for Avista, and the utility industry in general?

A. In September 2007, The Edison Foundation commissioned a study from The Brattle Group titled, "Rising

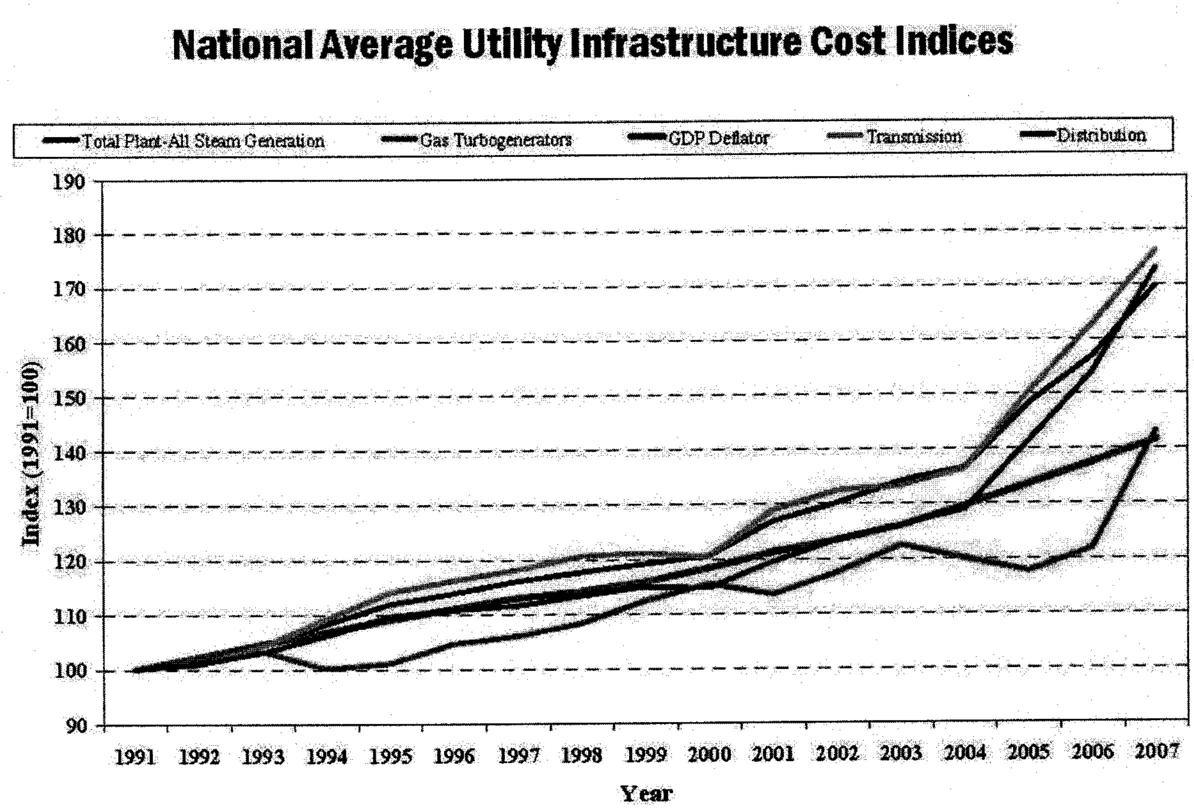
Utility Construction Costs: Sources and Impacts," which identified cost trends specifically related to the utility industry pertaining to critical materials and equipment, as well as labor support services used for building capital infrastructure. The study identifies the reasons for drastic cost increases in critical raw materials, such as global competition and an aging domestic utility infrastructure as well as the need for additional infrastructure to accommodate growth in the near future.

Q. What are some of the key cost drivers that are cited in the study?

A. The study, at page 16, cites four major cost drivers, "(1) material input costs, including the cost of raw physical inputs, such as steel and cement as well as increased costs of components manufactured from these inputs (e.g., transformers, turbines, pumps); (2) shop and fabrication capacity for manufactured components (relative to current demand); (3) the cost of construction field labor, both unskilled and craft labor; and (4) the market for large construction project management, i.e., the queuing and bidding for projects." The study goes on to compare cost trends for various raw materials, critical equipment and labor services relative to the general inflation rate (GDP deflator). In addition, a cost trend is summarized by three key utility functional plant categories, including generation, transmission, and distribution plant. The study concludes that these inflation impacts have been outside the utility industry's control.

Illustration 2 below depicts what has occurred to infrastructure costs nationally. From the chart, it is apparent that starting in 2003, costs of distribution, transmission and generation infrastructure increased at a far more significant rate than the overall economy, as measured by the GDP deflator.

Illustration 2



Sources: The Handy-Whitman© Bulletin, No. 165 and the U.S. Bureau of Economic Analysis.Simple average of all regional construction and equipment cost indexes for the specified components. "Rising Utility Construction Costs: Sources and Impacts" Prepared by The Brattle Group for The Edison Foundation, September 2007

Q. Is there specific evidence that Avista is experiencing cost escalations similar to that indicated in the study?

A. Yes. As we explained in the recent general rate case, a sample was compiled of some materials and equipment that Avista routinely uses in order to support various infrastructure construction efforts that are part of the Company's annual capital requirements of purchases made from 2003 through 2008. The sample of materials was grouped into categories for typical electric and gas distribution capital projects as well as major electric substation projects. The cost summary indicated that the cost of the materials reviewed has risen sharply in most categories from 2003 to 2008. For the distribution plant group of materials, the average annual escalation impact from 2003 through 2007 is approximately 37%, which is equal to a cumulative increase over the four-year period of 178%. The escalation for the substation group of materials and equipment has been approximately 12% per year for the purchases Avista has made from 2003 to 2008, or a cumulative increase of 55%.

Q. What is the historical and projected level of annual capital spending for Avista?

A. Avista's capital requirements have steadily increased from approximately $100 million to over $200 million over the last several years. Exhibit No. 9, Schedule 1 reflects the trend that Avista has experienced and what is planned for in the near future.

This chart not only shows the total magnitude of capital expenditures, but also clearly shows that the amount of capital projects is well in excess of <u>revenue-supported</u> capital expenditures to connect new customers, and beyond the level of revenues that is being collected from customers related to existing plant. The difference between the total capital requirements, less the new revenue related capital, and allowed revenues represent a significant discrepancy that is negatively impacting the Company.

Q. What is the likelihood that Avista's capital investment will continue at this level?

A. There are many factors that will influence capital expenditures going forward. One factor is the cost of raw materials is expected to continue to cause the cost of new capital expenditures to significantly exceed the cost of existing capital facilities that are to be replaced and the fact that there is more demand for capital projects for such things as compliance work with municipal highway and road projects, sewer projects, etc. Also, as critical systems age, there will be more utility plant that will be reaching the end of physical life and, in some cases, plant may be replaced prior to the end of its physical life based on power efficiency improvements that can be recognized.

III. DESCRIPTION OF CAPITAL PROJECTS

Q. For the 2009 capital projects pro formed in this filing, please provide a description of the projects.

A. Exhibit No. 9, Schedule 2 details the capital projects that will be transferred to plant in service in 2009 and included in this filing. A short description of these projects with system costs follows:

Generation ($37.9 million):

Thermal - Kettle Falls Capital Projects - $1,735,000
The primary project at the Kettle Falls Generating Station is the replacement of the steam turbine control system. Other smaller projects include the replacement of wood screw conveyors which feeds wood into the hopper, the replacement of ash screws in the ash removal system, and a continuation of a project to replace the travelling grate in the boiler.

Thermal - Colstrip Capital Additions- $6,200,000
The Colstrip capital additions for 2009 include major emission control projects for units 3 & 4. Boiler modifications are being made to reduce Mercury emissions on units 3&4 to comply with Montana state law. Also Low NOx burners are being installed on unit 4 to comply with Montana DEQ requirements. These NOx modifications were previously installed on unit 3. 2009 is a regular overhaul year with additional major capital work scheduled for unit 4 including cooling tower fill replacement, an LP turbine overhaul, an air pre-heater overhaul, a generator rewind kit, and a variety of additional smaller capital projects to be completed during the outage.

Thermal - Other Small Projects - $84,000
Please refer to the workpapers of Mr. DeFelice for detailed listing of projects.

Hydro - Cabinet Gorge Capital Project - $804,000
Replace a major component of the Cabinet Unit 1 Turbine (discharge ring).

Hydro - Little Falls Capital Project - $525,000
Replace the roof at the Little Falls HED.

Hydro - Long Lake Capital Project - $597,000
Replace the scroll case drain system and installation of dam safety monitoring systems for the forebay, tailrace, and sump.

Hydro - Noxon Capital Project - $1,295,000
Replacement of the Generator Step Up Transformers (GSU) needed to accommodate the increased power due to the turbine improvements.

Hydro - Upper Falls Capital Projects - $1,910,000
This project will replace the old plant control and locate all new equipment from the Post Street Substation to the Upper Falls plant. In addition, new equipment will be installed to both modernize the unit, enhance the protection schemes, and to automate the plant from the Generation Control Center.

Hydro - Noxon Capital Projects - $17,171,000
Projects include finishing the replacement of the Unit 1 stator core and stator windings, installation of a new high efficiency turbine runner, and mechanical overhaul on unit #1.

Hydro - Clark Fork Implement PME Agreement - $2,107,000
Multiple projects are planned for 2009 as part of the protection, mitigation and enhancement (PME) plan. These projects were agreed to as part of the settlement agreement and FERC license received in 2001.

Hydro - Other Small Projects - $1,142,000
There are a number of project improvements planned for 2009. These include beginning a system station sump control and monitoring systems to facilitate anticipated license conditions, and other small projects. Please refer to the workpapers of Mr. DeFelice for detailed listing of projects.

Other - Northeast Combustion Turbine - $944,000
The control system at the Northeast Combustion Turbine will be upgraded for standby reserve. This project is

a continuation from 2008 in that air permit issues prevented this item from being completed.

Other - Coyote Springs 2 (CS2) Capital Projects - $575,000
In 2009, capital costs include a spare GSU transformer. The previous spare was installed after a transformer failed in the spring of 2008. The capital cost of the new spare will largely be offset by an insurance settlement. Other smaller projects planned for 2009 include the purchase of a spare station serviced transformer (reliability), duct burner fuel system upgrades (capacity increase), steam turbine control upgrades (reliability), and several smaller PGE/Avista shared projects (safety/reliability).

Other - Coyote Springs 2 (CS2) LTSA - $2,000,000
LTSA (Long Term Service Agreement) costs are apportioned between capital and O&M based on predicted gas turbine hardware replacement schedules for the duration of the contract. These costs cover the maintenance agreement with General Electric and cover the gas turbine and auxiliaries.

Other Small Projects - $819,000
This work is primarily to install an Uninterruptable Power Supply (UPS) system at the Boulder Park power station to protect the engine generators and other station auxiliaries. Currently when there is a loss of station service, most of the control system will shut down after only a few minutes. This system will allow for an orderly control of the equipment during these events. Please refer to the workpapers of Mr. DeFelice for detailed listing of other projects.

Electric Transmission ($15.1 million):

The electric transmission projects that will transfer to plant in service are described in detail in Mr. Kinney's direct testimony at pages 17 through 21. A listing of these projects follows:

Lolo 230-Rebuild 230 kV Yard - $2,050,000
Spokane-CDA 115 kV Line Relay Upgrades - $1,250,000
Power Circuit Breakers - $540,000
SCADA Replacement - $740,000
Noxon-Pinecreek 230kV: Ready Fiber Optic - $650,000
System-Replace/Install Capacitor Banks - $800,000
Benewah-Shawnee 230 kV Construction - $560,000
Mos23-N Moscow 115 Recond - $585,000

Burke 115 kV Protection & Metering - $525,000
Beacon Storage Yard Oil Containment - $527,000
Other small specific transmission projects - $936,000
Transmission Minor Rebuild - $1,069,000
System Rebuild Transmission - $928,000
Interchange and Borderline Metering Upgrades - $642,000
Pine Creek - $350,000
Replacement Programs - $2,234,000
Other small transmission projects - $670,000

Electric Distribution ($46.7 million):

The electric distribution projects that will transfer to plant in service are described in detail in Mr. Kinney's direct testimony at pages 22 through 24. A listing of these projects follows:

Electric Distribution Minor Blanket - $7,922,000
Capital Distribution Feeder Repair Work - $4,100,000
Wood Pole Management - $3,700,000
Electric Underground Replacement - $3,156,000
T&D Line Relocation - $2,297,000
Failed Electric Plant - $1,987,000
Sys-Dist Reliability-Improve Fdrs - $1,100,000
Open Wire Secondary Elimination - $1,000,000
Plummer-Increase Capacity/Rebuild - $1,525,000
Idaho Road Sub/Rathdrum - $4,896,000
System Wood Substation Rebuilds - $3,600,000
Distribution Feeder Reconductor - ID - $727,000

The electric distribution projects specific to the Washington jurisdiction that are not described in detail in Mr. Kinney's direct testimony follows:

Spokane Electric Network Capacity - $1,615,000
Terre View 115-Sub Construct (WSU) - $1,962,000
Otis Orchards Substation - $980,000
Othello Transformer Replacement - $665,000
Northeast Substation - $225,000
Valley Mall Transfer Capacity - $200,000
Distribution Feeder Reconductor - WA - $1,050,000
Network Transformers & Network Protectors - $800,000

Additional distribution projects follows:

Power Transformer-Distribution - $680,000
Installation of distribution power transformers as required.

ID AMR - $600,000
The 4-year Automated Meter Reading Project was completed in late 2008. Additional capital will be for network optimization.

WSDOT Highway Franchise Consolidation - $800,000
In order to operate our electric system within State highway rights of way, the Company needs to establish new Franchises. Existing franchises have expired and Avista must seek new agreements with the State or risk penalties or non-approval by the State.

Other small distribution projects - $1,083,000
Please refer to the workpapers of Mr. DeFelice for detailed listing of projects.

General ($14.8 million):

Security Initiative - $508,000
Various security measures including cameras and access controls for the office and branch facilities.

Next Generation Radio System - $1,500,000
Antiquated Radio system technology necessary to operate the business is being refreshed to comply with changing FCC regulation.

Structures and Improvements - $3,360,000
This is a group of capital maintenance projects that Facilities Management coordinates at the Spokane Central Operating Facilities and Avista branch facilities - offices and service centers. For 2009, some of the projects include: roof replacements, land acquisition for facility expansion, HVAC system replacement at some branch offices, energy efficiency projects, security projects, emergency generators, asphalt overlays and replacement, and office furniture additions and replacement.

Stores Equipment - $598,000
Equipment utilized in warehouses and/or investment recovery operations throughout the service territory. This includes equipment such as forklifts, man lifts, shelving, cutting/binding machines, etc.

Tools, Lab & Shop Equipment - $1,285,000
Expenditures in this category include all large tools and instruments used throughout the company for gas and/or electric construction and maintenance work, distribution, transmission, or generation operations,

telecommunications, and some fleet equipment (hoists, winch, etc) not permanently attached to the vehicle.

Productivity Initiative - $1,147,000
Various initiatives that increase productivity benefits based on future avoided costs.

HVAC Renovation Project - $4,159,000
The heating, ventilating, and air conditioning systems throughout the Spokane Central Operating Facilities are approximately fifty years old and are in need of replacement. The project involves replacing central air handling units and distribution systems in three buildings - the Spokane Service Center, the general office building, and the cafeteria auditorium building. The building envelope of the general office building will also be renovated with high efficiency glass and insulation. New controls will also be installed which will enable energy conservation.

Spokane Central Operating Facility Crescent Realignment - $1,500,000
Vacate a city street that bisects the Spokane campus to eliminate public traffic across parking lots and operating facilities, improving facility safety and security.

Other Small Projects - $750,000
These projects include communication and security initiatives, radio equipment, telephone systems, office and other general facility upgrades.

Transportation ($9.6 million):

Transportation Equipment - $9,635,000
Expenditures are for the scheduled replacement of trucks, off-road construction equipment and trailers that meet the company's guidelines for replacement including age, mileage, hours of use and overall condition. In addition, includes additions to the fleet for new positions or crews working to support the maintenance and construction of our electric and gas operations.

Technology ($11.5 million):

Information Technology Refresh Blanket - $4,410,000
A program to replace obsolete technology according to Avista's refresh cycles that are generally driven by

hardware/software manufacturer and industry trends to maintain business operations.

Information Technology Expansion Blanket - $981,000
A program to deliver technology associated with expansion of existing solutions.

AFM Product Development Program - $1,115,000
Deliver enhancements to the electric and natural gas Facility Management technology system.

Nucleus Product Development Program - $556,000
Deliver enhancements to the Nucleus energy resource management technology system.

Web Product Development Program - $627,000
A program to deliver enhancements to the Customer based Web technology system.

Mobile Dispatch Upgrade - $800,000
Upgrade the Mobile Dispatch application system from V7.7 to V8.

Mobile Dispatch 2 - $1,372,000
Implement Mobile Dispatch application for electric service and meter shop processes.

Other Small Technology Projects - $1,655,000
These projects include various small technology projects including, technology to provide for field office use of Learning Management System, a Meter Data Management solution, a work management technology system to the Generation Production and Substation Support organization, and replacement of existing Real Estate permits application which is end-of-life with Valumation Contract Management System.

Jackson Prairie Storage ($0.3 million):

Jackson Prairie Storage Project - $306,000
This completes the capital project that Avista and its partners started for an expansion project at Jackson Prairie for deliverability that was in service in the fall of 2008.

Natural Gas Distribution ($22.2 million):

Replace Deteriorated Pipe - $1,000,000
This annual project will replace sections of existing gas piping that are suspect for failure or have

deteriorated within the gas system. This project will address the replacement of sections of gas main that no longer operate reliably and/or safely. Sections of the gas system require replacement due to many factors including material failures, environmental impact, increase leak frequency, or coating problems. This project will identify and replace sections of main to improve public safety and system reliability.

Gas Replacement Street and Highways - $1,200,000
This annual project will replace sections of existing gas piping that require replacement due to relocation or improvement of streets or highways in areas where gas piping is installed. Avista installs many of its facilities in public right-of-way under established franchise agreements. Avista is required under the franchise agreements, in most cases, to relocate its facilities when they are in conflict with road or highway improvements.

Gas Non-Revenue Blanket - $2,500,000
This annual project will replace sections of existing gas piping that require replacement to improve the operation of the gas system but are not directly linked to new revenue. The project includes relocation of main related to overbuilds, improvement in equipment and/or technology to improve system operation and/or maintenance, replacement of obsolete facilities, replacement of main to improve cathodic performance, and projects to improve public safety and/or improve system reliability.

East Medford Reinforcement Project - $4,451,000
This Oregon gas distribution project is not included in this filing.

Replace Gas ERT's w/ Batteries >10yrs - $2,700,000
This project will replace Gas ERT's that are greater than 10 years old, which is their economic life. ERT battery life is finite and although that life is greater than 10 years, it is cost effective to replace the ERTS's prior to them failing in the field. This project will ensure continued reliable metering operation by ensuring the ERT technology operates properly. Approximately 12,000 ERT's will be replaced in Washington and 21,000 in Oregon.

Kettle Falls Relocation - $5,198,000
This multi-phased project installed a new gate station in 2008 on the west side of Spokane to serve the

existing high pressure (HP) distribution and future replacement pipe that is part of the Kettle Falls HP main. The existing Kettle Falls Gate Station and HP Kettle Falls main have experienced significant encroachment due to growth in the north Spokane area. Sections of the main will be relocated to ensure continued safe reliable operation of the pipe system. The new gate station will improve the safety and reliability of operating the high pressure main and improve the gate station delivery capacity into the Kettle Falls HP system. Future phases of this project will re-route sections of the existing HP Kettle Falls main to improve system capacity and public safety.

US2 North Spokane HP Reinforcement (Kaiser Property) - $1,199,000
This project will reinforce the north central portion of Spokane near US2 by extending the existing HP piping system and installing a new regulator station to reinforce the existing distribution system. The north Spokane distribution system experiences low pressures during high system demand in the winter. The area fails the gas planning model for a design day. Growth in the area has reduced Avista's ability to reliably serve gas from its existing distribution system during a design day. This project will improve delivery pressure and reliability.

Other Small Projects - $3,901,000
Please refer to the workpapers of Mr. DeFelice for detailed listing of projects.

IV. ADJUSTMENT METHODOLOGY

Q. What was the general approach to computing the pro forma adjustments for investment in capital projects?

A. The Company used the same general approach that was used in the previous general rate case. The 2008 and 2009 capital investments were tracked separately to simplify the computation and to make it easier to follow. For each vintage, capital additions, depreciation and DFIT were computed to derive rate base at December 31, 2008 and

December 31, 2009 and to compute operating expenses in the pro forma rate year.

Q. What reports or data were used in the computation?

A. The Company maintains results of operations reports that are prepared for each service and jurisdiction on an average of monthly averages (AMA) basis and on an end of period (EOP) basis that were used in this computation. Actual 2008 plant additions were used from the plant accounting system to determine the month of addition and the amount of additions that were for revenue producing projects. Capital additions for 2009 (described above) were based on specific capital requirements for 2009. Capital additions for 2009 that were for revenue producing projects were separated out and excluded. The Company did not include any 2010 capital additions in this filing.

Q. Are the computations for all services and jurisdictions the same?

A. Yes, they are. Because of this, only the Idaho electric data will be used below to describe the methodology for computing the adjustments. The adjustments for Idaho gas were computed in a similar manner.

Q. Please explain in detail the computation of the adjustment as it relates to rate base.

A. There are three steps to determine the rate base adjustment at December 31, 2008 and December 31, 2009, as follows:

Step 1 - Adjust AMA September 30, 2008 to EOP December 31, 2008 (Pro Forma Capital Additions 2008 Adjustment)

The first step was to determine an adjusted December 31, 2008 EOP net plant balance that includes only the AMA revenue producing capital through September 30, 2008. The Company's December 31, 2007 EOP results of operations reports was the starting point.

The gross plant at December 31, 2007 at EOP includes all revenue producing capital added in 2007. Since the test period begins with October 1, 2007, it is necessary to remove the average of monthly averages of those additions for the last three months of 2007, since 2007 test year includes AMA customers and revenue (this is explained further below). The 2008 capital additions, excluding all revenue producing capital, were added. In addition, the average of monthly averages of the revenue producing capital for the nine months ended September 30, 2008 was also added.

The EOP gross plant at December 31, 2008 was computed as follows:

	($000's)
EOP Gross Plant at 12/31/07 per Results of Operations	$912,978
Add: 2008 Capital Additions (Excluding Revenue Producing)	$32,380
Less: October – December 2007 Revenue Producing Capital Additions	($1,590)
Add: January – September 2008 AMA Revenue Producing Capital Additions	$2,821
EOP Adjusted Gross Plant at 12/31/08	$946,589

The pro forma capital additions 2008 adjustment in Company witness Ms. Andrews' testimony at Exhibit No. 10, Schedule 1, page 8, for gross plant of $27,213,000 was computed by subtracting the AMA gross plant balance used in the filing of $919,376,000 from the calculated EOP adjusted gross plant balance of $946,589,000. Additional details regarding these adjustments are provided in Ms. Andrews' workpapers.

This same process was used for both accumulated depreciation and deferred income taxes, to arrive at EOP adjusted amount at December 31, 2008 for the 2008 vintage plant assets. The pro forma capital additions adjustment for accumulated depreciation of $19,393,000 was computed by subtracting the AMA accumulated depreciation balance used in the filing of $314,219,000 from the calculated EOP adjusted accumulated depreciation balance of $333,612,000. The pro forma capital additions adjustment for DFIT of ($4,162,000) was computed by subtracting the AMA DFIT balance used in the filing of ($82,407,000) from the calculated EOP adjusted DFIT balance of ($86,5695,000).

Step 2 - Adjust 2008 Vintage Plant to EOP December 31, 2009 (Pro Forma Capital Additions 2009 Adjustment - Part A)

The second step was to determine rate base at December 31, 2009 for the 2008 vintage plant assets. Only accumulated depreciation and deferred taxes are impacted. Depreciation expense of $25,467,000 was computed on gross plant at December 31, 2008, adjusted for projected 2009 retirements, using the average effective depreciation rates by functional plant group. Depreciation expense on the 2008 revenue producing capital additions has been excluded. The deferred tax impact on the 2008 vintage plant assets, was ($3,460,000). These changes to rate base at December 31, 2009 are added to the 2009 vintage plant additions (discussed below) to derive the pro forma capital additions adjustment for 2009, detailed in Ms. Andrews' testimony at Exhibit No. 10, Schedule 1, page 8. Additional details regarding these adjustments are provided in Ms. Andrews' workpapers.

Step 3 - Add 2009 Vintage Plant to EOP December 31, 2009 (Pro Forma Capital Additions 2009 Adjustment - Part B)

The capital additions for 2009 were summarized by functional plant categories and either directly assigned or allocated to the services and jurisdictions based on standard Company practices. The amount of revenue producing capital additions in 2009 by service and jurisdiction was excluded. The additions were further summarized by the month they are expected to be transferred to plant in service. Using the average effective depreciation rates by functional plant group, AMA depreciation expense was computed in order to include the partial year convention of depreciation that will actually be recorded in 2009.

For the Idaho electric service, plant additions were $47,447,000, depreciation expense was $846,000 and DFIT was ($778,000). These 2009 costs are added to the 2008 vintage plant 2009 costs (discussed above) to derive the pro forma capital additions adjustment to rate base for 2009.

A summary of the pro forma capital additions 2009 adjustment follows:

($000's)	Part A 2008 Vintage Plant	Part B 2009 Vintage Plant	Total Adjustment to Rate Base
Plant in Service	$0	$47,447	$47,447
Accumulated Depreciation	$25,467	$846	$26,313
DFIT	($3,460)	($778)	($4,238)

Q. What other impact does the 2008 and 2009 capital additions have on this case in addition to the rate base impact?

A. Depreciation expense and property taxes have been computed for the 2008 and 2009 plant vintages for the pro forma rate year.

The pro forma capital additions 2007 pre-tax depreciation adjustment of $246,000 is computed as follows:

	($000's)
Estimated full-year of depreciation expense on the 2008 vintage plant balance at December 31, 2009	$25,360
12 Months Ended September 30, 2008 test year depreciation expense, adjusted for the depreciation true-up adjustment.	$25,111
State Taxes	($3)
Pro forma Capital Additions 2007 Adjustment – Depreciation Expense	$246

The pro forma capital additions 2009 pre-tax depreciation and property tax adjustment of $2,603,000 is computed as follows:

	($000's)
Estimated full-year of depreciation expense on the 2009 vintage plant balance at December 31, 2009	$1,932
Estimated full-year of property taxes on the 2009 vintage plant balance at December 31, 2009	$699
State Taxes	($28)
Pro Forma Capital Additions 2009 Adjustment - Depreciation and Property Tax Expense	$2,603

<u>V. OTHER CONSIDERATIONS</u>

Q. What is the rationale behind the removal of capital expenditures for connecting new customers?

A. The pro forma capital expenditures for 2009 that the Company included in this filing <u>excludes</u> distribution related capital expenditures made that are associated with connecting new customers to the Company's system. The Company recognizes the fact that new customers provide incremental revenue that helps offset the revenue requirements of the distribution related capital additions that the Company incurs to provide service to those customers. These adjustments completely eliminated the AMA 2008 and EOP 2009 capital activity related to new customer connections in order to avoid an unintended mismatch of revenues exceeding the cost to serve customers.

Q. In addition to excluding capital additions related to new customers, does the Company address the 2009/2008 revenue difference in other ways?

A. Yes. The production property adjustment (discussed in Ms. Andrews' testimony) addresses the production and transmission related retail revenue that would be produced by the change in retail load expected in 2009/2010 compared to the 2008 normalized test year. All pro forma production and transmission rate base and related expenses from these capital additions adjustments, are reduced in order to reflect the amount needed to be recovered from 2008 sales volumes.

VI. CONCLUSION

Q. What is the impact of the pro forma adjustment?

A. The proposed adjustment will result in a closer matching of revenues to cost of service to customers during the period new rates will be in effect from this general rate proceeding. Without the proposed adjustment, the Company would not have the opportunity to earn its allowed rate of return on investment during the rate year.

Q. Does this conclude your pre-filed direct testimony?

A. Yes, it does.

DAVID J. MEYER
VICE PRESIDENT AND CHIEF COUNSEL OF
REGULATORY & GOVERNMENTAL AFFAIRS
AVISTA CORPORATION
P.O. BOX 3727
1411 EAST MISSION AVENUE
SPOKANE, WASHINGTON 99220-3727
TELEPHONE: (509) 495-4316
FACSIMILE: (509) 495-8851

RECEIVED
2009 JAN 23 PM 12:43
IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

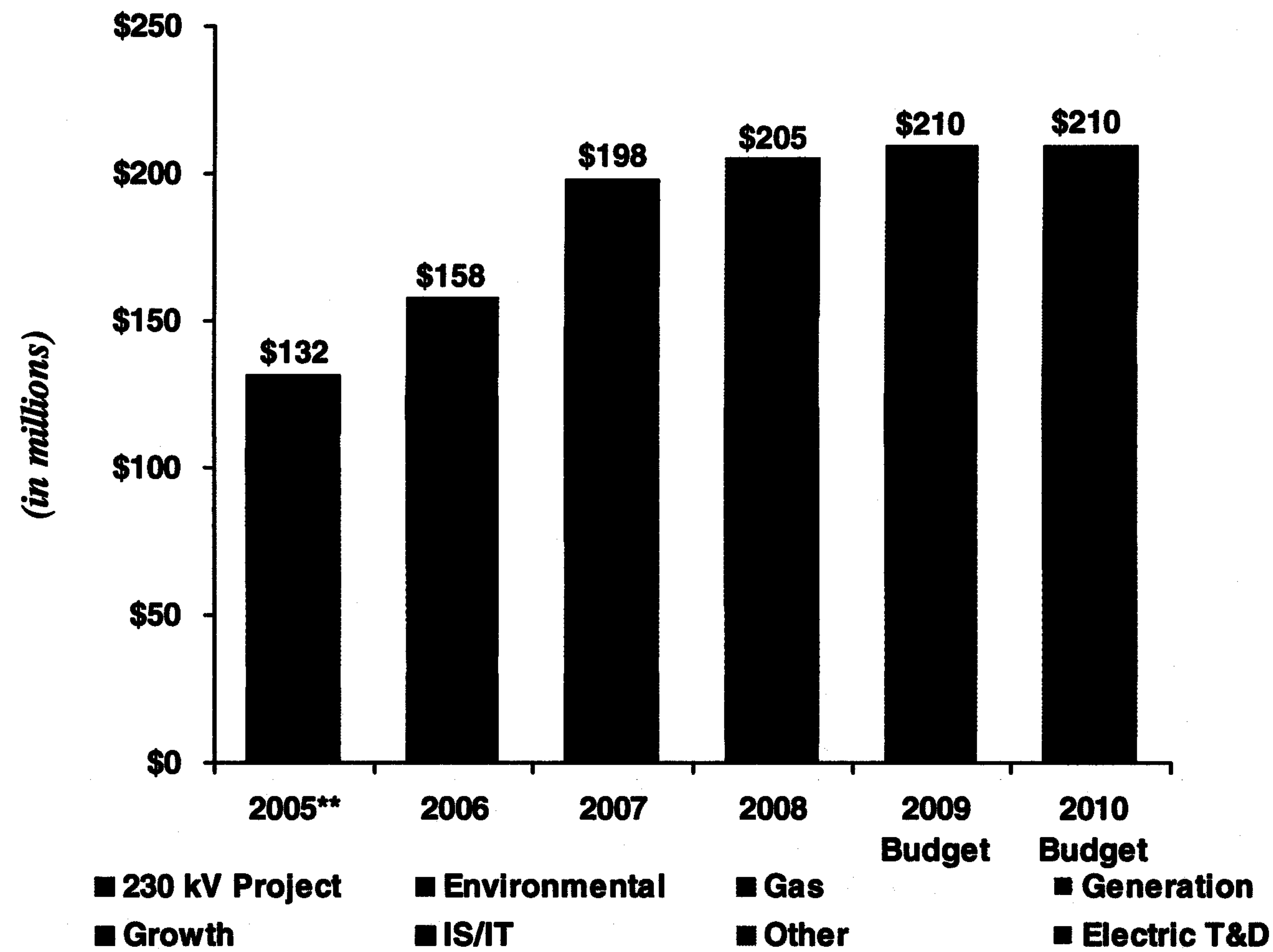
IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION FOR THE AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC AND NATURAL GAS SERVICE TO ELECTRIC AND NATURAL GAS CUSTOMERS IN THE STATE OF IDAHO	CASE NO. AVU-E-09-01 CASE NO. AVU-G-09-01 EXHIBIT NO. 9 DAVE B. DEFELICE

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

AVISTA Corp.

Capital Expenditures



** 2005 excludes $57.5 for the purchase of the second half of Coyote Springs 2 and $17.8 for the office building purchase.

Exhibit No. 9
Case Nos AVU-E-09-01 &
AVU-G-09-01
D. DeFelice, Avista
Schedule 1 p. 1 of 1

Avista 2009 Capital Additions Detail (System)

	$ (000's)
Generation:	
Thermal - Kettle Falls Capital Projects	1,735
Thermal - Colstrip Capital Additions	6,200
Thermal - Other small projects	84
Hydro - Cabinet Gorge Capital Projects	804
Hydro - Little Falls Capital Projects	525
Hydro - Long Lake Capital Projects	597
Hydro - Noxon Capital Projects	1,295
Hydro - Upper Falls Capital Projects	1,910
Hydro - Noxon Rapids Unit 1 Runner Upgrade	17,171
Hydro - Clark Fork Implement PME Agreement	2,107
Hydro - Other small projects	1,142
Other - Northest Combustion Turbine Projects	944
Other - CS2 Captital Projects	575
Other - CS2 LTSA	2,000
Other small generation projects	819
	37,908
Electric Transmission:	
Lolo 230 - Rebuild 230 kV Yard	2,050
Spokane-CDA 115 kV Line Relay Upgrades	1,250
Power Circuit Breakers	540
SCADA Replacement	740
Noxon-Pinecreek 230kV:Ready Fiber Optic	650
System-Replace/Install Capacitor Banks	800
Benewah-Shawnee 230 kV Construction	560
Mos23-N Moscow 115 Recond	585
Burke 115 kV Protection & Metering	525
Beacon Storage Yard Oil Containment	527
Other small specific transmission projects	936
Transmission Minor Rebuild	1,069
System Rebuild Transmission	928
Interchange and Borderline Metering Upgrades	642
Pine Creek	350
Replacement Programs	2,234
Other small transmission projects	670
	15,056
Electric Distribution:	
Electric Distribution Minor Blanket	7,922
Capital Distribution Feeder Repair Work	4,100
Wood Pole Management	3,700
Electric Underground Replacement	3,156
T&D Line Relocation	2,297
Failed Electric Plant	1,987
Spokane Electric Network Capacity	1,615
Sys-Dist Reliability-Improve Fdrs	1,100
Open Wire Secondary Elimination	1,000
Plummer-Increase Capacity/Rebuild	1,525
Idaho Road Sub/Rathdrum	4,896
System Wood Substation Rebuilds	3,600
Terre View 115-Sub Construct (WSU)	1,962
Otis Orchards Substation	980
Othello Transformer Replacement	665
Northeast Substation	225
Valley Mall Transfer Capacity	200
Power Xfmr-Distribution	680
Distribution Feeder Reconductor - ID	727
Distribution Feeder Reconductor - WA	1,050
ID AMR	600
Network Transformers & Network Protectors	800
WSDOT Highway Franchise Consolidation	800
Other small distribution projects	1,083
	46,670

	$ (000's)
General:	
Security Initiative	508
Next Generation Radio System	1,500
Structures & Improvements	3,360
Stores Equipment	598
Tools Lab & Shop Equipment	1,285
Productivity Initiative	1,147
COF HVAC Improvement	4,159
Spokane Central Oper Fac N Crescent Realignment	1,500
Other small general projects	750
	14,807
Transportation:	
Transportation Equipment	9,635
Technology:	
Information Technology Refresh Blanket	4,410
Information Technology Expansion Blanket	981
AFM Product Development Program	1,115
Nucleus Product Development Program	556
Web Product Development Program	627
Mobile Dispatch Upgrade	800
Mobile Dispatch 2	1,372
Other small technology projects	1,655
	11,516
Gas Storage:	
Jackson Prairie Storage	306
Natural Gas Distribution:	
Replace Deteriorating Gas System	1,000
Gas Replace-St&Hwy	1,200
Gas Distribution Non-Revenue Blanket	2,500
East Medford Reinforcement	4,451
Replace Gas ERTs w/ Batteries >10 yrs	2,700
Re-Rte Kettle Falls Fdr & Gate Station	5,198
US2 N Spo Gas HP Reinforce (Kaiser Prop)	1,199
Other small distribution projects	3,901
	22,150
Total Non-Revenue Capital	158,048
Growth/Revenue - Producing	47,510
Total Capital Additions in 2009	205,558

Exhibit No. 9
Case Nos. AVU-E-09-01and AVU-G-09-01
D. DeFelice, Avista
Schedule 2, p. 1 of 1