BEFORE THE

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IDAHO PUBLIC UTILITIES COMMISSION

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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-09-1/ AVU-G-09-1

DIRECT TESTIMONY OF KEITH HESSING

IDAHO PUBLIC UTILITIES COMMISSION

MAY 29, 2009

1 Q. Please state your name and business address for
2 the record.
3 A. My name is Keith D. Hessing and my business
4 address is 472 West Washington Street, Boise, Idaho.
5 Q. By whom are you employed and in what capacity?
6 A. I am employed by the Idaho Public Utilities
7 Commission as a Public Utilities Engineer.
8 Q. What is your education and experience
9 background?
10 A. I am a Registered Professional Engineer in the
11 State of Idaho. I received a Bachelor of Science Degree
12 in Civil Engineering from the University of Idaho in 1974.
13 Since then, I worked six years for the Idaho Department of
14 Water Resources, and two years for Morrison-Knudsen. I
15 have been continuously employed at the Commission since
16 August 1983.
17 As a member of the Commission Staff, my primary
18 areas of responsibility have been electric utility power
19 supply, revenue allocation and rate design.
20 Q. What is the purpose of your testimony in this
21 proceeding?
22 A. I will discuss electric issues including
23 Jurisdictional Separations, Class Cost of Service, Revenue
24 allocation to the various customer classes and the
25 Company's Power Cost Adjustment (PCA) mechanism.

1 Q. Please summarize your testimony.

2 A. I propose the following:

3 1) That Jurisdictional Separations methodology
4 not be changed.

5 2) That the Company's Class Cost of Service
6 study not be used to allocate revenue to customer classes.

7 3) That the increased revenue requirement be
8 allocated to customer classes on a uniform percentage
9 basis.

10 4) That PCA methodology be modified to include
11 third party transmission revenue and expense, the
12 Production Tax Credit, changes in Retail Revenue Credit
13 methodology and that Lancaster costs and benefits be
14 included in the PCA.

15 5) That the current PCA rate of 0.610 ¢/kWh be
16 reduced to 0.361 ¢/kWh to offset the average increase in
17 base rates proposed by Staff.

18 6) That the Production Property Adjustment
19 accepted by the Commission in the Company's last general
20 rate case be continued.

21 Jurisdictional Separations

22 Q. Have you reviewed the electric Jurisdictional
23 Separations methodology and allocation factors employed by
24 Avista in this filing?

25 A. Yes.

1 Q. Does the Company's filing propose to change
2 Jurisdictional Separation methodology?
3 A. No. The Company proposes to use the same
4 methodology that it has used and that the Commission has
5 accepted for many years.
6 Q. Is it important that the methodology has not
7 changed?
8 A. Yes. Changes in methodology shift costs among
9 jurisdictions. Methodology changes should not be made
10 without compelling evidence and need for the change. When
11 the methodology does not change, jurisdictional cost
12 differences from the preceding case are driven by
13 jurisdictional characteristics (energy, demand, customer,
14 etc.) and accounting data. Consistent Separations
15 methodology leads to more stable customer rates.
16 Q. What Jurisdictional Separations methodology and
17 Jurisdictional Allocators does the Staff propose?
18 A. Staff proposes that the Commission accept the
19 electric methodology and allocation factors presented by
20 the Company.
21 Class Cost of Service
22 Q. Have you reviewed the Company's electric Class
23 Cost of Service (COS) Study?
24 A. Yes.
25 Q. Is the Company proposing to change the

1 methodology from that accepted by the Commission in recent
2 years?
3 A. No. For a great many years the Company has
4 proposed that the Peak Credit method be used to calculate
5 class cost of service and the Commission has accepted it.
6 In the Company's last general rate case, Case No.
7 AVU-E-08-01 a settled case, the rate increase was spread
8 on a uniform percentage basis to all customer classes.
9 The uniform percentage spread was used because load
10 research data was stale not because the Peak Credit COS
11 methodology was unacceptable. Stale load research data
12 impacts all COS methods.
13 Q. Did the Company update its load research data
14 for this filing?
15 A. No. The Company reports that load research data
16 is being updated during calendar year 2009 and that the
17 new data will not be available until after the end of the
18 year.
19 Q. Does the Company propose that the Commission use
20 COS results to guide its allocation of revenue to customer
21 classes in this case?
22 A. Yes. The Company has filed a COS study using
23 the Peak Credit method. The Company proposes movement
24 toward COS based on its study results.
25 Q. Has the Company addressed the stale Load

1 Research data question in its filing?

2 A. Yes. The Company has filed four other Peak
3 Credit COS studies that attempt to address the sensitivity
4 of the study to changes in load research results.

5 Q. Are you convinced that the stale load research
6 data should be used to determine class cost of service and
7 to guide the allocation of revenue to the various customer
8 classes?

9 A. No, I remain concerned because the sensitivity
10 analysis did not cover the scenario that I believe is most
11 likely. That scenario would have Residential Class peak
12 characteristics changing without offsetting changes in
13 other classes. I propose an alternative to COS based
14 revenue allocation below.

15 Revenue Allocation to Customer Classes

16 Q. What is your revenue allocation proposal?

17 A. I propose that revenue requirement be allocated
18 to customer classes on a uniform percentage basis. This
19 is the same allocation methodology that the Commission
20 approved in the Company's last case to deal with stale
21 Load Research data. It is an interim solution.

22 Q. What increase do you propose?

23 A. Staff witness Cecily Vaughn proposes an increase
24 in base electric revenues of $8,622,000 which is a 3.91%
25 increase in base rates. I propose that rates be adjusted

1 in each class to obtain a 3.91% increase in base revenue.

2 The Power Cost Adjustment (PCA) Mechanism

3 Q. Is the Company proposing changes to its PCA

4 mechanism?

5 A. Yes. In its filing Company witness Johnson

6 proposes several changes to its PCA mechanism. One change

7 is to increase Customer/Shareholder sharing percentages of

8 abnormal power supply costs from 90/10 to 95/5. Staff

9 witness Lobb addresses this proposal in his testimony. He

10 recommends that sharing remain at the current level of

11 90/10.

12 Q. Does the Company also propose a change to

13 include abnormal third party transmission revenues and

14 costs in the PCA?

15 A. Yes.

16 Q. Do you recommend that these costs and revenues

17 be included?

18 A. Yes, I do. Avista incurs third party

19 transmission costs when it purchases power and has it

20 wheeled or delivered to its service area by a third party.

21 Avista also incurs third party transmission costs when it

22 sells power and pays a third party to deliver it. Third

23 party transmission revenues occur when Avista is the third

24 party and is delivering power for others.

25 Q. Does the Company propose to change the way its

1 Retail Revenue Credit is calculated?
2 A. Yes, it does.
3 Q. What is the proposed change?
4 A. The Company's Retail Revenue Credit rate, called
5 a Load Growth Adjustment rate in Idaho Power Company's
6 PCA, is currently based on the marginal cost of obtaining
7 power. In a load growth situation, application of the
8 Retail Revenue Credit rate removes the cost of load growth
9 on the margin from abnormal power supply costs before the
10 PCA rate is calculated and, therefore, denies recovery of
11 load growth related power supply costs incurred at the
12 margin. The theory is that the growth in load causes the
13 Company to incur power supply costs at the marginal rate
14 and that those costs should be recovered as a result of a
15 general rate case - not a PCA case.
16 In this filing Avista proposes to base the
17 Retail Revenue Credit rate on the embedded cost of power
18 supply already included in rates. The Company's
19 calculations include the embedded fixed cost of production
20 and transmission included in rates and the variable cost
21 of production included in rates. The theory behind these
22 calculations is that the Company receives these revenues
23 that are embedded in rates when it sells an additional
24 load growth kWh and, therefore, should not be allowed to
25 recover them a second time in the PCA. The Company

1 proposes that these embedded costs, already being
2 recovered through retail rates, be removed from power
3 supply costs that are granted PCA treatment. This
4 treatment avoids a double recovery of embedded costs and
5 allows the Company full recovery of the marginal cost of
6 load growth.
7 Q. Do you support the Company's proposal to change
8 the calculation of the Retail Revenue Credit rate?
9 A. Yes for the reasons cited above. In addition,
10 in the Settlement Stipulation accepted by the Commission
11 in Avista's last general rate case, Case No. AVU-E-08-01,
12 this method was employed although a long-term change in
13 the methodology was not discussed or ordered.
14 Q. Does Avista propose another change to its
15 existing PCA mechanism?
16 A. Yes. Avista proposes to include in the PCA
17 amounts that differ from the amount included in base rates
18 for the Production Tax Credit (PTC). Avista receives a
19 production tax credit for energy generated at Kettle Falls
20 and for the Cabinet Gorge upgrade. The normal Production
21 Tax Credit reduces the revenue requirement in base rates.
22 The credit is directly related to Company power supply
23 costs and varies with energy production.
24 Q. Do you believe that the Production Tax Credit
25 should be included in the PCA?

1 A. Yes I do, for the reasons cited above. Allowing
2 the credits to be included in the PCA will assure all the
3 benefits received in 2009 related to Kettle Falls are
4 passed on to customers without harming the Company when
5 the Kettle Falls PTC expires. Any new tax credits similar
6 to the PTC or extensions to existing credits that are
7 authorized in the future, should also be credits in the
8 PCA. This will allow customers to receive the benefits in
9 a fair manner.
10 Q. Does the Company make one more proposal that
11 would modify the PCA on a short-term interim basis?
12 A. Yes it does. The Company proposes that the
13 impacts of the Lancaster combined cycle combustion turbine
14 (CCCT) Tolling Agreement be included in the PCA. The
15 Company proposes to include 100% of the fixed costs for
16 PCA recovery and to apply the PCA sharing percentage to
17 variable costs. The Combustion Turbine becomes a Company
18 contract resource on January 1, 2010. Because this date
19 is well after the date that rates will become effective in
20 this rate case, it is not reasonable to include the cost
21 of Lancaster in base rates in this case.
22 Q. How does this treatment of Lancaster costs
23 differ from the normal circumstance?
24 A. Normally fixed costs would be included in base
25 rates and would receive no PCA treatment. There is

1 usually little or no variability in fixed costs. The
2 normal level of variable natural gas costs would also be
3 included in base rates. The PCA would capture only
4 variations from normal gas costs.
5 The Lancaster treatment proposed by the Company
6 in this case places unusual and substantial upward
7 pressure on PCA deferral balances that will remain until
8 fixed costs and normal levels of variable costs are moved
9 to base rates in the Company's next general rate case.
10 Q. Why not wait until the Company's next general
11 rate case to include Lancaster in base and PCA rates?
12 A. Beginning January 1, 2010, the PCA will
13 automatically begin to capture the benefits of the
14 resource. The shared benefits flow to Avista customers
15 through the PCA. The benefits are a reduced cost of
16 supplying load and profits from off system sales. It is
17 not fair to shareholders to require them to absorb the
18 costs of the resource while the PCA passes the benefits on
19 to customers.
20 Q. Does a new power supply resource always reduce
21 the Company's power supply costs?
22 A. The answer is yes if we are talking about the
23 variable power supply costs of the Company. This is true
24 because the resource is only run to meet load requirements
25 when it is the lowest cost alternative or to make off

1 system sales when sales revenues are higher than gas
2 costs.
3 Q. What about the fixed power supply costs
4 associated with a resource?
5 A. Fixed power supply costs are normally included
6 in base rates for full recovery in a general rate case
7 once those costs have been found to have been prudently
8 incurred. This circumstance differs in that full recovery
9 of fixed costs has been requested through the PCA
10 beginning January 1, 2010 when the resource becomes
11 available to the Company.
12 Q. What about the question of whether or not the
13 fixed costs associated with the resource were prudently
14 incurred?
15 A. Staff witness Randy Lobb addresses that question
16 is his testimony. He concludes that the fixed costs of
17 the resource have been prudently incurred.
18 Q. What impact would the Company's proposed PCA
19 treatment have on the PCA deferral balance?
20 A. If the Company's proposed treatment is adjusted
21 for 90/10 sharing as proposed by Staff, the inclusion of
22 Lancaster in the PCA would increase the annual deferral
23 balance by approximately $6.5 million in calendar year
24 2010.
25 Q. Do you support the Company's proposal to include

1 Lancaster fixed and variable costs in the PCA beginning
2 January 1, 2010?
3 A. I do. I believe it provides an equitable
4 balance between shareholders and ratepayers of Lancaster's
5 benefits and costs until the fixed costs and normal
6 variable costs can be placed in base rates in the
7 Company's next general rate case.
8 The Power Cost Adjustment Rate
9 Q. Does the Company propose to change the PCA rate
10 that is currently in place?
11 A. Yes, it does. The Company proposes a reduction
12 in the current PCA rate from 0.610 ¢/kWh to 0.257 ¢/kWh as
13 a temporary offset to the 12.8% increase in current rates
14 (14.2% increase in base rates) that it is proposing. This
15 would reduce the overall increase that customers would
16 experience on implementation of new rates by 5.0% to 7.8%.
17 The Company further proposes that the new PCA rate be
18 continued a year past its normal expiration date to
19 October 1, 2010 if deferral balances do not become too
20 large.
21 Q. What is your proposal for the existing PCA rate?
22 A. Staff proposes a much smaller general or base
23 rate increase than that proposed by the Company. The
24 Staff proposes a 3.91% base rate increase. Therefore, I
25 propose that the Commission offset the entire base rate

1 increase with an equivalent reduction in the PCA rate. A
2 reduction in the PCA rate from 0.610 ¢/kWh to 0.361¢/kWh
3 offsets Staff's proposed $8.622 million increase in base
4 rates.
5 Q. Would the net revenue requirement of all
6 customer classes be zero under your proposal?
7 A. No, because PCA rates affect class revenues on a
8 ¢/kWh basis and not an equal percentage basis. Some
9 classes will experience net increases and others will
10 experience net decreases. The increases and decreases
11 will average zero. Staff witness Bryan Lanspery shows
12 these results on Staff Exhibit No. 124. His exhibit shows
13 a PCA rate reduction of 0.2489 ¢/kWh across all customer
14 classes.
15 Q. How long will your proposal to offset the base
16 rate increase with a PCA rate decrease last?
17 A. It will last until one rate or the other
18 changes. The PCA rate is normally adjusted annually in
19 October. The Staff will review the PCA deferral balance
20 prior to October this year and make a recommendation to
21 the Commission. One of the alternatives that will be
22 addressed at that time is whether or not it is reasonable
23 to continue the PCA rate established in this case until
24 October 1, 2010.
25 Q. What is the effect of changing the PCA rate now

1 and possibly continuing the rate to October 1, 2010?

2 A. Reducing the rate reduces future revenue to
3 offset deferral balances. If the rate is reduced too much
4 it may have to be increased to amortize deferral balances
5 that are building faster than offsetting revenue. Of
6 course, if the opposite situation occurs, the rate would
7 have to be further reduced.

8 Q. What is the current and expected future status
9 of PCA deferrals?

10 A. The current PCA rate recovers approximately
11 $21.1 million per year. The rate was designed to recover
12 $9.6 million of last year's deferral balance during the
13 May through September period this year. If the rate is
14 reduced beginning July 2009, when I anticipate base rates
15 will change, I estimate that $2.5 million of the $9.6
16 million will be unrecovered on October 1.

17 In addition there is a balance of $7.2 million
18 in the deferral account for the first 10 months of the
19 current deferral year, through April of 2009. Assuming
20 PCA treatment of Lancaster costs as previously discussed,
21 six months (January through June) of those costs would
22 accumulate in the next deferral period. This is estimated
23 to be $5.0 million. The net effect of these deferrals
24 through June of 2010 would cause new PCA rates on October
25 1, 2010 to have to be increased $2.2 million. This

1 calculation assumes that the unknown non-Lancaster
2 deferrals from May 2009 through June 2010 net to zero.
3 The calculation follows:

4		Million $
5	PCA Revenue @0.361 ¢/kWh	12.5
6	Unrecovered balance (Jul-Sep 09)	-2.5
7	This years deferral (First 10 Months)	-7.2
8	Lancaster Deferrals (Jan-Jun 2010)	-5.0
9	Unknown Deferrals (May 2009-June 2010)	0.0
10	Net Deferral	-2.2

11 The unknown Deferrals category could increase by $8.6
12 million before the rate would return to the current rate
13 of 0.610 ¢/kWh.
14 The Staff proposal is more conservative than the
15 Company's proposal in terms of the PCA rate. The Company
16 proposes that the rate be reduced to 0.257¢/kWh which will
17 produce approximately $8.9 million in annual revenue. By
18 my calculation the Company's proposal will leave a
19 deferral shortfall in 2010 of approximately $5.8 million
20 if all other assumptions are the same.
21 Of course, the larger the reductions in the PCA
22 rate the greater the risk that the PCA rate will have to
23 be increased the next time it is adjusted.
24 In spite of the risk of having to increase the
25 PCA rate in October 2010, I continue to propose that the

current PCA rate be reduced to offset the base rate increase supported by Staff in this case. I believe the risk is justified based on good water conditions in northern Idaho and the current adverse economic climate as evidenced by customer comments in this case.

Q. In the event that the Commission approves a larger base rate increase than that proposed by Staff, do you propose that the Commission offset the entire increase with a PCA rate decrease?

A. I believe that offsetting the base rate increase with a PCA rate decrease is a good idea. However, I believe that it is appropriate to establish a limit to the size of the PCA rate reduction. I recommend the PCA rate not be reduced beyond the rate proposed by the Company. The Company's proposal is 0.257 ¢/kWh. This limit would allow the Commission to offset any base rate increase up to 5%.

The Production Property Adjustment

Q. Has the Company included a Production Property adjustment in its case?

A. Yes. The Company first proposed a Production Property adjustment in its last general rate case. In the settlement of that case the adjustment was accepted by the Commission.

Q. What is the purpose of the Production Property

1 adjustment?

2 A. The Production Property adjustment reduces the
3 revenue requirement calculation to offset increased
4 revenue requirement included in a case because the Company
5 reached out beyond the test year to include costs that it
6 expects to incur just before or during the first year the
7 new rates are expected to be in place. The revenue
8 requirement reduction compensates customers for a mismatch
9 between rate design load and costs that would be required
10 to support a higher future load. The adjustment is made
11 by removing a percentage of the projected costs equivalent
12 to the percentage amount of the projected load growth.

13 The methodology also affects the Retail Revenue
14 Credit calculated in the PCA because the base energy
15 amount included in the PCA is the projected amount
16 expected in the first year that new rates from this case
17 will be in place. If the load projection is exactly
18 correct, no Retail Revenue adjustment will be made in the
19 PCA because there will be no load difference between
20 actual and base.

21 A review of the results of this methodology
22 following the Company's last general rate increase
23 indicates that it is working as anticipated.

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

1 A. Yes, it does.
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 29TH DAY OF MAY 2009, SERVED THE FOREGOING **DIRECT TESTIMONY OF KEITH HESSING**, IN CASE NOS. AVU-E-09-1 & AVU-G-09-1, BY ELECTRONIC MAIL TO THE FOLLOWING:

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