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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)	CASE NO. AVU-E-10-01
OF AVISTA CORPORATION FOR THE)	CASE NO. AVU-G-10-01
AUTHORITY TO INCREASE ITS RATES)	
AND CHARGES FOR ELECTRIC AND)	
NATURAL GAS SERVICE TO ELECTRIC)	DIRECT TESTIMONY
AND NATURAL GAS CUSTOMERS IN THE)	OF
STATE OF IDAHO)	SCOTT L. MORRIS
)	

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

1 I. INTRODUCTION

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

4 A. My name is Scott L. Morris and I am employed as
5 the Chairman of the Board, President and Chief Executive
6 Officer of Avista Corporation (Company or Avista), at 1411
7 East Mission Avenue, Spokane, Washington.

8 Q. Would you please briefly describe your educational
9 background and professional experience?

10 A. Yes. I am a graduate of Gonzaga University with a
11 Bachelors degree and a Masters degree in organizational
12 leadership. I have also attended the Kidder Peabody School
13 of Financial Management.

14 I joined the Company in 1981 and have served in a
15 number of roles including customer service manager. In
16 1991, I was appointed general manager for Avista Utilities'
17 Oregon and California natural gas utility business. I was
18 appointed President and General Manager of Avista Utilities,
19 an operating division of Avista Corporation, in August 2000.
20 In February 2003, I was appointed Senior Vice-President of
21 Avista Corporation, and in May 2006, I was appointed as
22 President and Chief Operating Officer. Effective January 1,
23 2008, I assumed the position of Chairman of the Board,
24 President, and Chief Executive Officer.

Morris, Di 1
Avista Corporation

1 I am a member of the Western Energy Institute board of
2 directors, a member of the Gonzaga University board of
3 trustees, a member of Edison Electric Institute board of
4 directors, a member of the American Gas Association board of
5 directors, a member of ReliOn board of directors, and board
6 director of the Washington Roundtable. I also serve on the
7 board of trustees of Greater Spokane Incorporated.

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

10 A. I will provide an overview of Avista Corporation.
11 I will also summarize the Company's rate requests in this
12 filing, the primary factors driving the Company's need for
13 general rate relief, and provide some background on why
14 utility costs are continuing to increase. In addition to
15 major increases in power supply costs, the Company continues
16 to experience increasing costs from additional compliance
17 requirements, and the need to replace aging infrastructure.
18 It is simply not possible to cut other costs enough to
19 offset these cost increases.

20 My testimony will provide an overview of some of the
21 measures we have taken to cut costs, as well as initiatives
22 to increase operating efficiencies in an effort to mitigate
23 a portion of the cost increases. I will briefly explain the
24 Company's customer support programs in place to assist our

1 customers, as well as our communications initiatives to help
2 customers better understand the changes in costs that are
3 causing our rates to go up. Finally, I will introduce each
4 of the other witnesses providing testimony on the Company's
5 behalf.

6 A table of contents for my testimony is as follows:

7	<u>Description</u>	<u>Page</u>
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18 **Q. Are you sponsoring any exhibits in this**
19 **proceeding?**

20 **A. Yes. I am sponsoring Exhibit No. 1 pages 1 and 2.**
21 **Page 1 is a diagram of Avista's corporate structure; and**
22 **page 2 includes a map showing Avista's electric and natural**
23 **gas service areas. This exhibit was prepared under my**
24 **direction.**

25

26

II. OVERVIEW OF AVISTA

27 **Q. Please describe Avista's current business focus**
28 **for the utility and subsidiary operations.**

1 A. Our strategy continues to focus on our energy and
2 utility-related businesses, with our primary emphasis on
3 the electric and natural gas utility business. There are
4 four distinct components to our business focus for the
5 utility, which we have referred to as the four legs of a
6 stool, with each leg representing customers, employees, the
7 communities we serve, and our financial investors. For the
8 stool to be level, each of these legs must be in balance by
9 having the proper emphasis. This means we must maintain a
10 strong utility business by delivering efficient, reliable
11 and high quality service at a reasonable price to our
12 customers and the communities we serve, and provide the
13 opportunity for sustained employment for our employees,
14 while providing an attractive return to our investors.

15 **Q. Please briefly describe Avista's subsidiary**
16 **businesses.**

17 A. Avista Corp.'s primary subsidiary is the
18 information and technology business, Advantage IQ,
19 described below, which is headquartered in Spokane,
20 Washington. In 2007, Avista completed the sale of the
21 operations of Avista Energy to Coral Energy Holding, L.P.
22 Avista currently holds a 6.8% share in Avista Labs'
23 successor company, ReliOn, which is held under Avista

1 Capital. A diagram of Avista's corporate structure is
2 provided on page 1 of Exhibit No.1, Schedule 1.

3 **Q. Please provide an overview of Advantage IQ.**

4 A. Advantage IQ, formerly known as Avista Advantage,
5 commenced operations in 1998 and is a provider of utility
6 bill processing, payment and information services to multi-
7 site customers. Advantage IQ analyzes and presents
8 consolidated bills on-line, and pays utility and other
9 facility-related expenses for multi-site customers
10 throughout North America. Customers include, CSK Auto, Jack
11 in the Box, Staples, and Big Lots, to name a few.
12 Information gathered from invoices, providers and other
13 customer-specific data allows Advantage IQ to provide its
14 customers with in-depth analytical support, real-time
15 reporting and consulting services with regard to facility-
16 related energy, waste, repair and maintenance, and telecom
17 expenses. In 2007, 2008 and 2009, Advantage IQ was awarded
18 the ENERGY STAR® Sustained Excellence Award and in 2010,
19 received the Energy Management Award in recognition of its
20 continued leadership in protecting our environment through
21 energy efficiency.

22 **Q. Please briefly describe Avista Utilities.**

23 A. Avista Utilities provides electric and natural gas
24 service within a 26,000 square mile area of northern Idaho

1 and eastern Washington. Of the Company's 356,620 electric
2 and 316,350 natural gas customers (as of December 31, 2009),
3 122,358 and 74,006, respectively were Idaho customers. The
4 Company, headquartered in Spokane, also provides natural gas
5 distribution service in southwestern and northeastern
6 Oregon. A map showing Avista's electric and natural gas
7 service areas is provided on page 2 of Exhibit No. 1,
8 Schedule 1.

9 As of December 31, 2009, Avista Utilities had total
10 assets (electric and natural gas) of approximately \$3.6
11 billion (on a system basis), with electric retail revenues
12 of \$705 million (system) and natural gas retail revenues of
13 \$397 million (system). As of December 2009, the Utility had
14 1,538 full-time employees.

15 Avista has a long history of innovation and
16 environmental stewardship. At the turn of the 20th century,
17 the Company built its first renewable hydro generation plant
18 on the banks of the Spokane River. In the 1980's, Avista
19 developed an award-winning biomass plant (Kettle Falls) that
20 generates energy from wood-waste.

21 To the future, Avista as well as other utilities are
22 facing new state and federal mandates for renewable energy
23 and carbon control standards. Recognizing these changes, the
24 Company did not model any coal-fired generation in its 2009

1 electric IRP, instead relying on natural gas, renewables,
2 and energy efficiency. Today, Avista has one of the
3 smallest carbon footprints in the U.S.

4 **III. SUMMARY OF RATE REQUESTS**

5 **Q. Please provide an overview of Avista's electric**
6 **rate request in this filing.**

7 A. Avista is proposing an increase in electric billed
8 retail rates of \$32.1 million or 13.1%. The Company's
9 request is based on a proposed rate of return of 8.55% with
10 a common equity ratio of 50% and a 10.9% return on equity.

11 Mr. Ehrbar will provide details related to rate spread
12 and rate design. The proposed rate spread for the increase
13 to each electric customer class is shown in the illustration
14 below.

15 **Illustration No. 1:**

16		Proposed
17	<u>Service Schedule</u>	<u>Increase</u>
18	Residential Service Schedule 1	14.5%
19	General Service Schedules 11 & 12	13.3%
20	Large General Service Schedules 21 & 22	13.6%
21	Extra Large General Service Schedule 25	11.3%
22	Clearwater Paper Schedule 25P	9.4%
23	Pumping Service Schedules 31 & 32	17.1%
24	Street & Area Lighting Schedules 41-49	<u>13.3%</u>
25	Overall Increase	13.1%
26		

1 Q. What is Avista's natural gas rate request in this
2 filing?

3 A. With regard to natural gas, the Company is
4 requesting an increase of \$2.6 million or 4.1% of billed
5 rates. As with the electric increase, the Company's request
6 is based on a proposed rate of return of 8.55% with a common
7 equity ratio of 50% and a 10.9% return on equity. The
8 proposed rate spread for each natural gas customer class is
9 shown in the illustration below.

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Illustration No. 2:

<u>Service Schedule</u>	<u>Proposed Increase</u>
General Service Schedule 101	4.9%
Large General Service Schedule 111	1.1%
Interruptible Sales Service Schedule 131	2.2%
Transportation Service Schedule 146	<u>1.9%</u>
Overall Increase	4.1%

20 Q. What are the primary factors causing the Company's
21 request for an electric rate increase in this filing?

22 A. The Company's electric general rate case test
23 period is based on 12-months ending December 31, 2009, and
24 an October 1, 2010 through September 30, 2011 pro forma
25 period. As shown in Illustration No. 3, the Company's
26 electric request is driven primarily by an increase in
27 production and transmission expenses, due to the addition of

1 the Lancaster plant Power Purchase Agreement (PPA), in base
 2 rates, the termination of some low-cost power purchases,
 3 reduced hydro generation, and increased fuel costs and
 4 higher retail loads. These costs equate to approximately
 5 80% of the Company's overall request. In addition, 12% of
 6 the request is due to the increased net plant investment in
 7 the Company's hydro and thermal generation projects, and
 8 transmission and distribution upgrades.

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10 **Illustration No. 3:**

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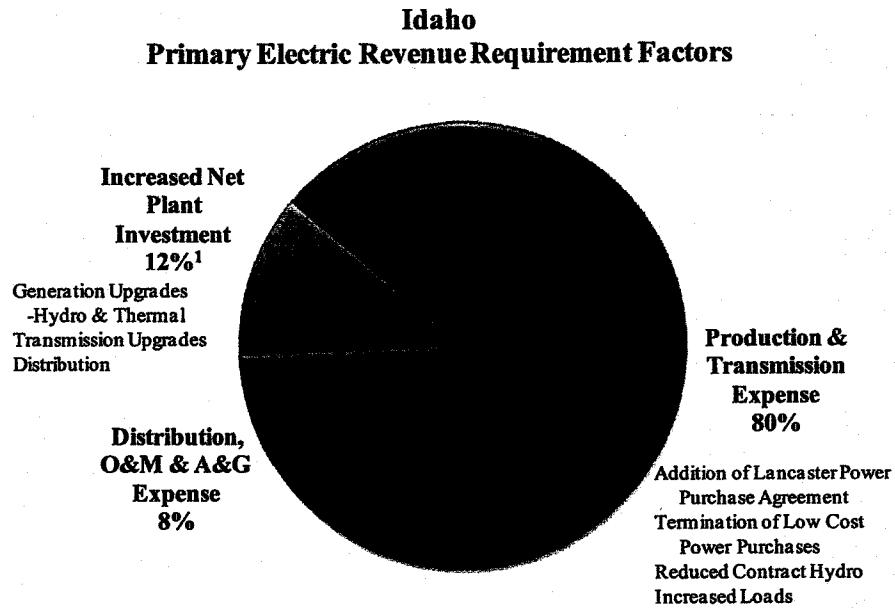
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¹Includes return on investment, depreciation and taxes, offset by the tax benefit of interest.

1 Later witnesses provide details explaining these
2 changes in costs.

3 **Q. What are the primary factors driving the Company's**
4 **request for a natural gas rate increase?**

5 A. The Company's natural gas request is primarily
6 driven by the inclusion in this case of the increased plant
7 investment and inventory associated with the transfer of
8 additional capacity and deliverability in the Jackson
9 Prairie Storage facility from Avista Energy to Avista
10 Utilities, effective May 1, 2011. Company witness Mr.
11 Christie discusses the details of this project. Other
12 changes are due to various operating cost components, mainly
13 administrative and general expenditures.

14 **Q. Is the Company proposing any changes to the cost**
15 **of natural gas for its retail natural gas customers in this**
16 **case?**

17 A. No. Avista is not proposing changes in this filing
18 related to the cost of natural gas included in current rates
19 for natural gas customers. Changes in natural gas costs are
20 addressed in the annual purchased gas adjustment (PGA)
21 filings.

22

23

24

1 IV. BACKGROUND FOR PROPOSED RATE CHANGES

2 Q. Would you please provide some background on the
3 changes in costs the Company is experiencing, which are
4 leading to the need for increased rates?

5 A. Yes. Although we would like to avoid any rate
6 increase request under the current economic circumstances,
7 as I will explain later in my testimony we have no other
8 choice. Some of our customers have made the comment that
9 we should "tighten our belt" and cut costs - and we have
10 done that. The fact is we are experiencing major cost
11 impacts such that it is not possible to cut other costs
12 enough to offset them, and still be able to meet mandatory
13 compliance requirements and provide safe, reliable service
14 to our customers.

15 I am going to get into a little more detail in my
16 testimony than I have historically, because as we listen to
17 our customers it is evident that it is even more important
18 now, given the current state of the economy, that we
19 clearly explain to all of our stakeholders the cost changes
20 and circumstances that we are experiencing. And because
21 technology today allows all of our stakeholders ready-
22 access to this testimony and the other documents of our
23 filing, we are hopeful that the additional detail and
24 explanation will promote a better understanding by all

1 stakeholders of why it is necessary for us to request a
2 rate increase at this time.

3 **Q. Why is it necessary to file a rate increase**
4 **request?**

5 A. The Company is experiencing major increases in
6 power supply costs, as well as increased costs from
7 additional compliance requirements, and the need to
8 continually replace aging infrastructure. The current
9 ratemaking process employed by the Commission is to
10 establish new retail rates for only the one upcoming year
11 that the new rates will be in effect. The process does not
12 allow recovery of costs beyond that first year. The only
13 way to recover increasing costs to serve customers is to
14 file a new rate request every year.

15 **Q. Do other states have ratemaking processes that**
16 **set rates for multiple years, so that an annual rate filing**
17 **is not necessary?**

18 A. Yes. Some states use formula-based or multi-year
19 rate making mechanisms to avoid rate filings every year.
20 For example, in the state of California, the CPUC in 2008
21 approved multi-year settlements in Southern California Gas
22 Company's general rate case (Application 06-12-010), which
23 provided a \$59 million rate increase in 2008, \$52 million
24 in 2009, \$51 million in 2010, and \$53 million in 2011. The

1 CPUC order directed SCG to file in 2010, two years later,
2 to address cost recovery beginning in 2012.

3 The use of formula-based or multi-year ratemaking
4 would reduce the administrative burden for regulators and
5 the Company associated with filing cases every year. It
6 would also reduce frustration for customers who see not
7 only news of annual rate filings, but also multiple news
8 stories within the same year for the same rate case related
9 to the Company's rate proposals. There is media coverage on
10 Commission Staff and intervener proposals, proposals on
11 rebuttal, and finally another news story following the rate
12 decision by the Commission.¹ The multi-year mechanisms can
13 include protections for both customers and the Company to
14 ensure that there is not a material over-recovery or under-
15 recovery of costs during the multi-year period.

16 Although we have not proposed a multi-year mechanism
17 in the current filing, I am hopeful that we can work
18 together collaboratively in the future toward some solution
19 to avoid these types of filings year after year.

20 **Q. What is the nature of the cost changes that have**
21 **caused the Company to file this rate request?**

¹Due to this confusion, often some customers believe we have multiple increases in a single year because of these multiple media stories.

1 A. Let me give you a couple of examples. As Mr.
2 Storro explains in his testimony, we currently have 100 aMW
3 of purchased power agreements that began in 2004 and end on
4 December 31, 2010. Our average retail load is
5 approximately 1,100 aMW, so the 100 aMW supplies a
6 meaningful portion (9%) of our customers' load. The cost
7 of these agreements is approximately 3 cents per kWh, which
8 is well below the cost to replace this power. The
9 expiration of these contracts alone will increase our power
10 supply costs by approximately \$10 million on a system
11 basis, which equates to a rate increase to customers of
12 approximately 1.6%. These contracts have provided
13 substantial benefits to our customers since 2004, but will
14 expire at the end of this year.

15 A second example is the addition of the Lancaster
16 Project generation to our system. While Lancaster is a
17 very low cost resource compared to other resource
18 alternatives available to us, its cost is higher than our
19 existing low-cost resource base, which results in increased
20 costs to serve our customers. The net additional cost
21 associated with Lancaster is approximately \$21 million per

1 year, which equates to a rate increase to customers of
2 approximately 3.3%².

3 I want to emphasize the impacts that resource changes
4 can have on our total resource costs, because we are a low-
5 cost utility. For example, if a utility with a resource
6 portfolio having an embedded cost of power of 7 cents per
7 kWh, adds a new resource with a cost of 7 cents per kWh, it
8 would result in essentially no rate increase to customers,
9 because the cost of the new resource is the same as the
10 cost already built into base rates. However, Avista's
11 embedded cost of resources to serve customers is
12 approximately 4.3 cents/kWh. Therefore, the addition of a
13 new long-term firm resource at 7 cents/kWh would result in
14 an increase in costs, and rates, to our customers.

15 Although our low-cost resource base is a substantial
16 benefit to our customers, when these low-cost resources
17 expire or we need to add new resources, it results in rate
18 increases for our customers. These same resource changes
19 may have little impact on other utilities because they
20 already have higher rates.

² Costs associated with the Lancaster Power Purchase Agreement have been previously found to be prudent by this Commission in AVU-E-09-01, but are presently being recovered through the Company's PCA in Idaho, until such time as such costs are transferred into base rates in this proceeding. (See testimony of Avista Witness Johnson for further discussion.)

1 These two issues alone (expiration of the low-cost
2 contracts, and the addition of the Lancaster Project)
3 represent a rate increase of approximately \$11 million
4 (Idaho share) or 4.8%, which is approximately 34% of the
5 Company's overall request. It is simply not possible to
6 cut other costs enough to offset these kinds of increases.

7 **Q. What else has caused the need to request a rate
8 increase?**

9 A. As a regulated company, we operate under what has
10 been referred to as a "regulatory compact." As part of
11 that compact, although we are provided with an opportunity
12 to make a fair profit, that profit is limited by the
13 regulators. And under that same compact we have an
14 obligation to serve all customers with safe, reliable
15 service. When a new customer wants service, we must hook
16 them up, even if the cost to serve that customer results in
17 increased costs to all other customers. Likewise, if the
18 facilities serving an existing customer are deteriorating
19 and need repair, we must repair or replace them so that the
20 customer continues to receive safe, reliable service.

21 As I mentioned earlier, we occasionally receive
22 comments from some of our customers to the effect that
23 Avista should cut its costs, and "tighten its belt," like
24 other businesses are having to do in these difficult

1 economic circumstances, and keep retail rates the same. We
2 hear those comments and take them to heart, but we are not
3 like other businesses. Without the obligation to serve, we
4 could consider refusing to hook up some new customers,
5 because it could avoid a further increase in costs to our
6 existing customers. Without an obligation to serve, we
7 could consider no longer serving some of the more remote,
8 more costly areas to provide service, which would allow us
9 to avoid further investment, and reduce labor and other
10 costs. Unregulated businesses have the opportunity to shut
11 down under-producing retail outlets, eliminate product
12 lines, and cut back on investment, maintenance, and other
13 costs.

14 Please don't misunderstand my point -- we do have
15 opportunities to cut back on investment and operating
16 costs, and we have. I will address that later in my
17 testimony. But those opportunities are limited by our
18 obligation to safely and reliably serve all customers, and
19 our obligation to comply with numerous mandatory state and
20 federal requirements.

21 In recent years there has been a significant increase
22 in costly, mandatory requirements on utilities related to,
23 among others things, reliability, environmental compliance,
24 safety, and security. These mandates, together with

1 litigation and other claims related to the ownership and
2 operation of hydroelectric resources, have added, and
3 continue to add, significant costs to run the utility. The
4 penalties associated with non-compliance with some of these
5 requirements can be as much as \$1 million per day per
6 violation.

7 We simply don't have the choice to say no to new
8 customers, no to maintaining a safe, reliable system, and
9 no to mandatory requirements. Although we have taken
10 extensive measures to ensure that the costs that we incur
11 represent the most cost-effective and reliable way to
12 continue to serve our customers, we continue to experience
13 significant increases in costs.

14 **Q. Can you provide some examples of the state and**
15 **federal mandates and other costs recently imposed on the**
16 **utility?**

17 A. Yes. Most of the larger cost impacts are on the
18 electric side of the utility. Just for context, our
19 electric retail revenues in 2009 (on a system basis) were
20 approximately \$700 million and our average electric rate
21 base for 2009 was approximately \$1.6 billion (system).

22 Under federal law we must have a license to operate
23 our hydro-electric projects to serve customers. In recent
24 years we negotiated new licenses for the projects on both

1 the Clark Fork and Spokane rivers. The cost to gain new
2 licenses was over \$40 million up front and approximately
3 \$600 million over the life of the new licenses (45 to 50
4 years). These costs reflect aggressive bargaining on the
5 part of the Company to keep the costs as low as possible.
6 The requirements in the new long-term licenses address
7 environmental and cultural protection while preserving our
8 low-cost hydroelectric resources for the benefit of our
9 customers, but they also represent significant increases
10 in costs associated with owning and operating our hydro-
11 electric system.

12 In addition, the recent settlement with the Coeur
13 d'Alene Tribe related to the US Supreme Court decision
14 granting the Tribe ownership of the lower one-third of Lake
15 Coeur d'Alene cost \$39 million up front and over \$175
16 million over a 50 year term.

17 Recent claims in Montana related to Avista's use of
18 the bed and banks of the Clark Fork River for hydro-
19 electric generation resulted in costs of over \$47 million
20 for the first 10-year period beginning in 2007, after which
21 the annual amount will be renegotiated. In addition, there
22 are new mercury emission limitation requirements in Montana
23 effective in 2010 related to our ownership interest in the
24 Colstrip Generating Projects that required capital

1 investment up front and annual costs of \$1.5 million per
2 year (Avista share).

3 With regard to reliability requirements, the Energy
4 Policy Act of 2005 changed the national reliability
5 standards for utilities, enforced by the North American
6 Electric Reliability Corporation (NERC), from voluntary to
7 mandatory beginning June 2007. Non-compliance with any of
8 the requirements may result in monetary penalties up to \$1
9 million per day per violation. The reliability standards are
10 focused primarily on system operation, transmission planning
11 and equipment maintenance.

12 The planning standards require utilities to perform
13 planning studies at least 10 years in the future to ensure
14 sufficient facilities are in place to avoid real time loss
15 of customers or impact to neighboring utilities for the loss
16 of transmission facilities. The transmission system must be
17 designed and operated so that the simultaneous loss of up to
18 two facilities will not impact the interconnected
19 transmission system. If a potential violation is observed
20 in the future analysis, then Avista must develop a project
21 plan to ensure that the violation is fixed prior to it
22 becoming a reality. Avista budgets for future projects and
23 ensures that the design and construction of the required
24 projects are completed prior to the time they are needed.

1 The NERC standards require Avista to continually invest in
2 its transmission system to maintain system reliability based
3 on load growth, the addition of new generation, and system
4 configuration changes. These requirements have been, and
5 will continue to be, very costly.

6 Avista has incurred significant O&M costs since 2007 to
7 adhere to the mandatory reliability standards. Several new
8 positions have been added as a result of the NERC
9 reliability standards becoming mandatory. A Compliance
10 Manager and Analyst have been hired to coordinate the
11 Company's compliance program. The Company has also added an
12 additional System Operator to allow adequate time for
13 operator training, a Training Coordinator to train, track
14 and manage all the extensive training needs and continuing
15 education hours required for System Operators to maintain
16 certification, and two additional engineers to support the
17 new Critical Infrastructure Protection standards. Avista
18 was required to construct a redundant Backup Control Center
19 at a cost of approximately \$6 million to meet one of the
20 emergency operating standards. Avista also has
21 approximately 25 subject matter experts that spend anywhere
22 from 10-30% of their time working on compliance initiatives
23 and documentation.

1 I could go on, but I believe the point has been made
2 related to the significant costs associated with the recent
3 mandates and other costs imposed on the Company. And this
4 is prior to talking about new requirements and costs related
5 to mandatory renewable portfolio standards, new and higher
6 energy efficiency requirements, and the potential future
7 costs associated with climate change.

8 **Q. During the 1990s Avista filed for very few changes**
9 **in base retail rates. What were the circumstances that**
10 **allowed Avista to not change rates during that period?**

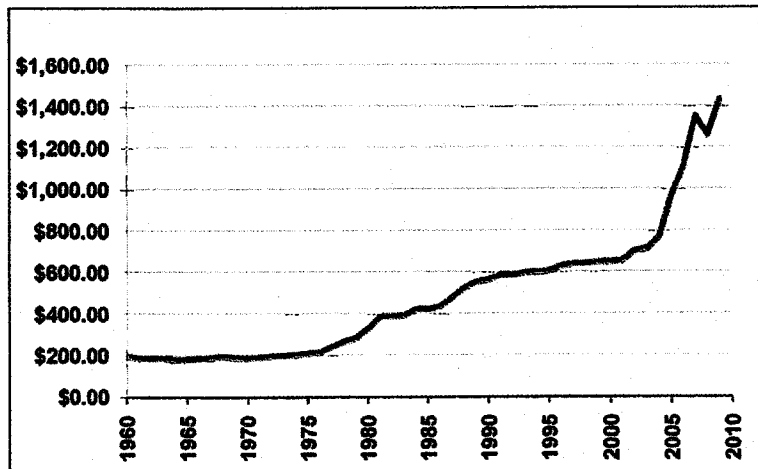
11 A. Avista and other regional utilities had surplus
12 energy during the 1990s, and the wholesale cost of power
13 generally was in the range of 1.5 to 2.0 cents/kWh. As
14 retail loads grew, the incremental cost of power to serve
15 customers was equal to or less than the amount embedded in
16 retail rates, and therefore growing loads did not create
17 retail price pressure. As is evident from the discussion
18 above, we have many more mandates and compliance
19 requirements now than in the 1990s. In addition, our
20 utility infrastructure in the 1990s was generally newer and
21 in better condition, and required less capital investment.
22 The combination of an aging infrastructure and more
23 stringent reliability requirements has resulted in the
24 necessity to invest in generation, transmission and delivery

1 infrastructure to ensure reliability and compliance with new
2 mandates. Finally, among other things, the higher cost of
3 materials for utility equipment today, versus the 1990s, has
4 had a significant impact on the cost to own and operate the
5 utility today.

6 **Q. Has there been a dramatic change in the cost of**
7 **materials in recent years?**

8 A. Yes. One example is the cost of a 15 kVA
9 distribution transformer, which is what is commonly used to
10 step-down the voltage for our residential electric
11 customers. The chart below shows the change in the cost of
12 these transformers for the past 50 years. What is
13 noteworthy is the rapid escalation that has occurred in the
14 more recent years, i.e., the cost has essentially doubled in
15 the last six years.

16 **15 KVA Distribution Transformer**



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