BEFORE THE

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IDAHO PUBLIC UTILITIES COMMISSION

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IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION DBA AVISTA UTILITIES FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC AND NATURAL GAS SERVICE IN IDAHO.	)	CASE NO. AVU-E-10-1/ AVU-G-10-1

DIRECT TESTIMONY OF RANDY LOBB IN SUPPORT OF THE STIPULATION AND SETTLEMENT

IDAHO PUBLIC UTILITIES COMMISSION

AUGUST 5, 2010

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

A. My name is Randy Lobb and my business address is 472 West Washington Street, Boise, Idaho.

Q. By whom are you employed?

A. I am employed by the Idaho Public Utilities Commission as Utilities Division Administrator.

Q. What is your educational and professional background?

A. I received a Bachelor of Science Degree in Agricultural Engineering from the University of Idaho in 1980 and worked for the Idaho Department of Water Resources from June of 1980 to November of 1987. I received my Idaho license as a registered professional Civil Engineer in 1985 and began work at the Idaho Public Utilities Commission in December of 1987. My duties at the Commission currently include case management and oversight of all technical Staff assigned to Commission filings. I have conducted analysis of utility rate applications, rate design, proposed tariffs and customer petitions. I have testified in numerous proceedings before the Commission including cases dealing with rate structure, cost of service, power supply, line extensions, regulatory policy and facility acquisitions.

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

A. The purpose of my testimony is to describe the Stipulation (the Proposed Settlement) filed in this case and to explain the rationale for Staff's support.

Q. Please summarize your testimony.

A. Staff believes that the comprehensive Proposed Settlement resolving all issues in the general rate case and agreed to by all parties participating in the settlement process[1] is in the public interest, is just and reasonable and should be approved by the Commission.

Q. How is your testimony organized?

A. My testimony is subdivided under the following headings:

Stipulation Overview

Q. Please provide an overview of the Stipulation and Settlement.

A. The Stipulation filed with the Commission

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[1] The Idaho Community Action Network and North Idaho Energy Logs, Inc., as intervenors, were provided notice of the settlement discussions, but did not participate.

provides for an annual overall increase in electric base revenue of $21.25 million or 9.25%. This increase is partially mitigated for the first two years by using $17 million in Deferred State Income Tax (DSIT) credits to offset a portion of the increase.

With the credit offset, the first year average net increase for electric service will be $8.25 million or 3.59% effective October 1, 2010. The second year increase will be an additional $9 million or 3.92% and the third year increase when all credits are exhausted will be an additional $4 million or 1.74%.

The Stipulation provides for an overall increase in natural gas revenue of $1.85 million or 2.62%. This increase is mitigated in the first year by using $500,000 in DSIT credits to offset a portion of the increase. With the credit, the first year revenue increase will be $1.35 million or 1.9% effective October 1, 2010. The remaining increase of 0.72% will occur in the second year when the credit expires.

The Stipulation and Settlement specifically identifies annual power supply cost levels for the Power Cost Adjustment (PCA) mechanism, supports a prudency finding for 2008 and 2009 Demand Side Management(DSM) expenditures, specifies rate spread to the individual classes and supports increased funding for low income DSM programs. The Stipulation also addresses accounting treatment for the Coeur d'Alene Tribe Settlement costs, Spokane River Relicensing costs, Colstrip lawsuit costs and Jackson Prairie Storage costs.

Finally, the Stipulation provides for workshops and discussion among the parties and the Company on a variety of issues including class cost of service, first block residential rate levels, and a variety of other consumer issues.

Although the Stipulation represents a comprehensive settlement of all revenue requirement issues in the case, it does not specifically identify revenue adjustments to the Company's case or specify an authorized return on equity (ROE).

Q. How does the annual revenue requirement increase for electric and gas service proposed in the Stipulation compare to the increase originally proposed by Avista?

A. Avista originally proposed to increase annual electric revenue by $32.114 million or 13.98% and increase annual natural gas revenue by $2.575 million or 3.6%. The Stipulated Settlement provides for an increase in annual electric revenue of $21.25 million or approximately 66% of the original request. That increase is further reduced by $13 million for one year and then by $4 million in the second year using the DSIT credits. Instead of paying an additional $32.114 million from October 1, 2010 to October 1, 2011, electric customers will only pay an additional $8.25 million or 26% of the original request. Through September 30, 2012, customers will pay a total of $25.5 million in additional electric costs or 40% of the $64.228 million that would have been required under the Company's original proposal.

The Stipulated Settlement provides for an increase in annual natural gas revenue of $1.85 million or 70% of the Company's original request. With the DSIT credit, the first year increase is $1.35 million or 52% of the Company's original request. The Stipulation and Settlement is attached as Staff Exhibit No. 101.

The Settlement Process

Q. Would you please describe the process leading to the Stipulated Settlement?

A. Yes. The Company contacted Staff the week of June 14, 2010 to discuss the possibility of scheduling a settlement workshop. Staff was scheduled to complete its company audit the same week and needed time to review its findings and develop its revenue requirement recommendations for hearing. Staff positions on cost of service, rate design and consumer issues were already well developed.

All parties were invited to attend or participate by phone in the settlement workshops on July 6 and July 8 in the Commission hearing room. Parties participating in both workshops included Commission Staff, Avista, Clearwater Paper Company, the Community Action Partnership Association of Idaho (CAPAI), the Idaho Conservation League and the Snake River Alliance. Idaho Forest Group only participated in the second workshop.

Settlement discussions were dominated by revenue requirement issues with additional discussions on other issues such as cost of service, rate design, low income weatherization funding and other customer service commitments. Revenue requirement discussion was framed by the electric and natural gas service increases proposed by the Company and the preliminary increase recommendation of Staff for electric service of approximately $16.4 million or 51% of the Company's proposal and for natural gas service of $792,000 or 31% of the Company's original proposal.

At the July 6, 2010 workshop the Company first proposed using $17.5 million in DSIT credits to mitigate the electric and gas service increases. Based on these revenue requirement positions and the positions of the parties on various other issues, negotiations ensued and the Stipulated Settlement was reached.

Q. How did the Commission Staff evaluate the

Stipulated Settlement to determine that it was reasonable?

A. In this case as in other past general rate cases, Staff evaluated the merits of the Stipulated Settlement by comparing it to the expected outcome if the case proceeded to hearing. In other words, Staff had to determine which process would result in the best deal for customers. In Staff's view, the best deal for customers is the lowest justifiable annual revenue requirement.

While the Commissioners make the ultimate decision on Company revenue requirement based on the record at hearing, it is the parties to the case that make revenue requirement adjustment recommendations on the record for the Commission to decide. The outcome at hearing in terms of revenue requirement must therefore be evaluated based on both the adjustments to the Company's revenue request that are presented on the record and how the Commission might decide each adjustment.

Revenue Increase and DSIT

Q. What type of adjustments to the Company's proposed revenue requirement had Staff identified and what was the dollar value of those adjustments?

A. As previously indicated, Staff's preliminary estimate of downward adjustments to the Company's proposed electric revenue increase of $32.114 million totaled approximately $15.7 million (a $16.4 million, 7.1%

increase) and approximately $1.78 million (a $792,000, 1.12% increase) on the natural gas service side. The big ticket issues identified by Staff for electric service included: an annual reduction in power supply costs of $6.8 million; a reduction in Return On Equity (ROE) to 10% for an annual revenue reduction of $4.3 million; elimination of all salary increases back to January 1, 2009 for a revenue reduction of $1.35 million, elimination of Lancaster transmission wheeling expense of $1.6 million; and elimination of working capital of $1.26 million. The remaining identified reduction of $550,000 in annual revenue consisted of 10 other individual adjustments.

On the natural gas side, Staff adjustments for ROE, salaries and removal of Jackson Prairie storage costs represented $1.5 million of the total identified revenue requirement reduction of $1.78 million.

Q. How confident was Staff that its adjustments could be justified on the record and accepted by the Commission upon hearing?

A. Staff took a very aggressive approach to developing its revenue requirement adjustments in preparation for testimony and in preparing for settlement negotiations. It is unlikely that all of the preliminary adjustments presented by Staff in negotiations would have survived ongoing review to be presented at hearing and it is unlikely that all of the adjustments presented at hearing would have been accepted by the Commission.

For example, Staff proposed eliminating 90% of the wheeling costs associated with the Lancaster power plant. These costs are actually incurred by Avista to wheel Lancaster power through Bonneville Power Administration's (BPA) system to Avista's service territory. While a reasonable argument could have been made to reduce the costs, it is questionable whether all of the recommended reduction would have been accepted.

In addition, Staff had to further develop justification to support the level of proposed reductions in salaries, ROE and working capital before it was presented in testimony. Company rebuttal at hearing could have presented arguments that some or all of the reductions were unjustified. On the gas service side, Staff would have had to offset the proposed revenue requirement reduction for removal of Jackson Prairie storage with benefits included in the Company's case that resulted from the addition of low cost natural gas storage.

Finally, Staff could not ignore the $17.5 million in DSIT benefits offered by the Company as part of the settlement. Given the complicated nature of the accrual and the difficulty in identifying the level of tax benefits already returned to customers, Staff was not confident that it could justify this level of credit to customers at hearing.

Q. How were the DSIT benefits derived and why are they now available to offset the present rate increase?

A. The deferred state income taxes are booked when there is a difference between the state income taxes paid and the amount reflected on the Company's books. When taxes and benefits are flowed through to customers, no DSIT is booked. When taxes and benefits are normalized, DSIT is booked.

Under normalization, the differential is then distributed to customers over the life of the assets. Federal and State tax laws usually dictate when normalization must occur. There are other accounting areas where the Company may elect to use either the flow-through method or the normalization method. This election once made is followed unless properly changed. The DSIT amounts discussed here are a result of Idaho taxes. No Federal or Washington State amounts are at issue.

Avista originally flowed these items through but changed to normalization when deregulation was being explored by many entities, both companies and commissions. Due to the timing of rate cases, not all DSIT reflecting the normalization methodology was included in rates. In the last general rate cases, Case Nos. AVU-E-09-1 and

AVU-G-09-1, the Company used the flow-through method for state income tax. With that change in accounting treatment, deferrals would not be booked. That left the DSIT balance of approximately $11 million on the books with a portion of those benefits belonging to customers. Avista offered the full amount of $17.5 million ($11 million grossed-up for taxes) as rate mitigation in the Settlement.

Q. Would all of the DSIT benefits used to mitigate the rate increase in settlement have been available to customers if this case had gone to hearing?

A. No. Staff believes that for a period of time DSIT was booked at a different level than was reflected in rates. In other words, customers actually received more tax benefits during the period than are reflected in the booked DSIT. Therefore, it could be demonstrated that the Company rather than customers is entitled to a larger portion of the $17.5 million DSIT.

Unfortunately, the mismatch in booked tax versus the ratemaking treatment over time makes it nearly impossible to accurately determine the exact allocation between customers and shareholders of the $11 Million ($17.5 million after tax gross-up) total DSIT booked during the period. It would require extensive study to track the actual amounts normalized in each case especially when there was a settlement or the amount is not shown in the rate case orders. Not only would it be time consuming and costly but the result could be subject to dispute. The Stipulated Settlement credits all of the DSIT to customers for maximum benefit.

Q. Did any other party to the case indicate intent to address the Company proposed revenue requirement in the rate case?

A. One party indicated that it might address appropriate ROE for the Company. Other than that, no parties planned to address revenue requirement issues.

Q. Why are a new return on equity and other specific revenue requirement adjustments not specified in the Stipulation?

A. Specific adjustments and ROE were not specified in the Stipulation to facilitate agreement on the overall revenue requirement. While the settlement parties generally agreed on a reasonable level of revenue, there was stark disagreement on the individual adjustments proposed to reach that revenue level. This was particularly true with respect to ROE. Rather than specify an ROE that all parties could not support, the Stipulation simply specified an overall revenue requirement that could be fully supported.

Q. Is the Company precluded from filing general rate cases over the next three years?

A. No. However, the issue of a rate case moratorium was discussed during negotiations. While Staff was concerned over the potential for multiple base rate increases in a single year and requested a moratorium as part of the Settlement package, it was not included in the final Stipulation. In exchange for the moratorium, the Company required an additional increase in revenue requirement that Staff and other parties were unable to support. The moratorium condition was therefore dropped in lieu of a lower overall revenue increase in this case.

Q. Could you please summarize why Staff supports the revenue requirement portion of the Stipulation?

A. Yes. Staff maintains that the combination of reduced base rate revenue requirement and the use of DSIT benefits to mitigate the increases as specified in the Stipulation is a better deal for customers than could have been achievable through hearings. Staff's best case scenario would have resulted in additional revenue of approximately $32.7 million over two years ($16.34 million each year), if all Staff adjustments proposed at settlement were accepted by the Commission. The Stipulated Settlement specifies additional electric revenue of $25.5 million over the two year period ($8.25 million in year one and 17.25 million in year two).

Given that neither Staff nor any other party had identified any DSIT benefits available to customers prior to settlement discussions, it is unclear how thoroughly this information could have been reviewed before prefiled direct testimony was due. Based on a preliminary review by Staff, it appears that over half of the $17.5 million DSIT might not have been normalized in rates so effectively may have already been flowed through to customers in past electric and natural gas rates. In any case, the amount of the DSIT available to customers would be subject to dispute at hearing. However, with the Stipulated Settlement customers receive the full $17.5 million of the DSIT benefit.

Class Cost of Service

Q. Please describe the Stipulated Settlement with respect to electric customer class cost of service and revenue spread among classes.

A. The Stipulation does not accept the Company's originally proposed class cost of service study but uses a less modified version of the cost of service study last approved by the Commission. The parties then agreed to move all classes one quarter of the way to "full" cost of service as proposed in the Company's original application.

Q. What was the cost of service modification and what was its impact?

A. The cost of service study originally submitted by the Company in this case showed that several customer classes were below cost of service including the residential class and several classes were above cost of service. The Company then proposed that all customer classes be moved one quarter of the way to "Full" cost of service. This means that once the overall revenue requirement increase is determined, those classes below cost of service would receive a larger portion of the increase and those above cost of service would receive a smaller portion of the increase.

The cost of service methodology initially proposed by the Company deviated from previously accepted cost of service methodology in three significant ways. It proposed a unique approach to the peak credit classification of production costs as energy or demand related; it classified all transmission costs as demand related instead of a split between demand and energy; and it used seven coincident peaks instead of all twelve monthly coincident peaks in formulating the major demand allocator. All of these proposed changes benefitted large, high load factor customers or customer groups.

The Company proposed the cost of service changes to benefit these customers because the Company observed that they were struggling in today's economy. Several large customers had down-sized and at least one had gone out of business. Staff observed that when costs are shifted away from large customers they are shifted to the other customer classes including the residential class, all of whom are also experiencing the downturn in the economy. In settlement, Staff accepted the classification that all transmission costs be demand related only because it is a more common cost of service practice.

The overall effect of settlement on cost of service is an increase in the cost responsibility of the residential class over what would have been allocated under previously approved cost of service methodology, but a lower allocation than that originally proposed by the Company.

All parties agreed that the one quarter move to full cost of service as originally proposed by the Company was reasonable. Staff recognizes that this relatively small move leaves some substantial room for movement in future cases.

Q. Did the parties agree to evaluate electric cost of service prior to the next Avista general rate case?

A. Yes. The parties agreed as part of the Stipulation to convene a public workshop to discuss the possibility of revising the peak credit method of classifying production costs. Possible revisions include the monthly production cost weightings (12cp vs. 7cp) and allocation of transmission costs.

Q. What did the parties agree to with respect to natural gas cost of service?

A. The parties agreed to accept the Company's proposed cost of service methodology and move all classes 60% toward full cost of service except for transportation service which will be moved fully to cost of service. Staff supported this position because the methodology was previously approved by the Commission and class increases required to achieve 60% of full cost of service were all within a reasonable range. Staff also supported a full decrease in transportation rates to provide a more accurate price signal reflecting cost of service for that class.

Rate Design

Q. The Stipulation provides for an increase in the monthly electric residential customer charge. Why does Staff support the increase?

A. The Company originally proposed to increase the monthly electric and natural gas customer charges from the current $4.60/month to $6.75/month and from $4.00/month to $6.75/ month, respectively. The Stipulation limits the increase in the electric customer charge to $0.40/month from the current $4.60/month to $5.00/month. No change in the monthly natural gas customer charge is proposed in the Stipulation.

Staff supported the limited customer charge increase as part of a negotiated settlement and to recognize the increased investment made by the Company to install more sophisticated automated meters.

Q. Are there any other rate design changes specified in the Stipulation?

A. No. The residential energy rate differential for electric energy consumption between the first and second block will not change from the differential that currently exists. This is consistent with the Company's original proposal and provides a reasonable spread between the first and second blocks in Staff's opinion. The Stipulation does include a provision to convene a public workshop prior to the Company's next general rate case to discuss the appropriate threshold between the size of the first tier and second tier energy blocks for residential electric service. Staff welcomes such a discussion.

Q. What are the new first year residential energy rates and what is the impact on customer bills?

A. The base residential energy rates will increase from $0.0695/kWh to $0.07775/kWh for the first 600 kWh per month and from $0.07867/kWh to $0.08691/kWh for energy use above 600 kWh per month. The differential between the first and second block rate is maintained at $0.0092/kWh. The first year base energy rates with the DSIT credit is

$0.0735/kWh for the first 600 kWh per month and $0.0818/kWh for energy use above 600 kWh per month. The residential rate impact of the proposed Stipulation and Settlement is shown on Staff Exhibit No. 102.

Natural gas rate changes for all customer classes are shown on page 7 of Attachment B to the Stipulation and Settlement.

DSM Prudency

Q. The Stipulation in this case includes an agreement that Avista's demand side management (DSM) expenses in 2008 and 2009 were prudently incurred for the benefit of its Idaho customers. What are the costs associated with DSM for those two years?

A. The testimony filed by Avista does not state Idaho-specific DSM costs, but the Company's 2008 and 2009 DSM annual reports contain this information. Table 14(EG) in the 2008 report indicates that $4,079,015 was spent for DSM funded by Idaho electricity customers and that $2,143,380 was spent for DSM funded by Idaho natural gas customers. Similarly, Tables 11 and 12 in the 2009 report show Idaho electricity-funded DSM costs of $5,335,909 and $2,468,528 of costs funded by Idaho natural gas customers.

Total DSM expenditures in Idaho for 2008 and 2009 were $9,414,924 funded by electricity customers and $4,611,908 funded by natural gas customers.

Q. How will the approximate $14 million spent by Avista for DSM programs affect electric and natural gas rates?

A. DSM costs will have no direct effect on tariffed energy rates because Avista's electricity and natural gas DSM programs are funded through energy efficiency tariff riders, Schedules 91 and 191, respectively. Indirectly, however, prudent and cost-effective DSM programs, by definition, reduce the total of all bills paid by Avista's customers. In short, while customers do pay for Avista's DSM programs through the energy efficiency tariff riders, a prudency finding for past expenses will not affect the base rates under consideration in this case.

Q. Why does Staff support a prudency finding for 2008/2009 DSM expenditures as part of the settlement in this case?

A. Staff believes that Avista's DSM efforts in 2008 and 2009 were generally reasonable and cost-effective and that sufficient progress is being made toward improving the processes and transparency of its program evaluations.

In last year's rate case (AVU-E-09-01 and AVU-G-09-01), the Staff recommended that Avista's request for a prudency finding of its January through November 2008 DSM costs be deferred "...until such time that the Company is able to provide more comprehensive evaluations of its DSM programs and efforts." After the conclusion of that case, the Staff convened a DSM evaluation workshop with Avista Utilities, Idaho Power Company and Rocky Mountain Power. The outcome of the workshop was a Memorandum of Understanding (MOU) signed in December 2009 by Staff and a representative of each of the three utilities. The MOU included evaluation and reporting prerequisites that will allow Staff to evaluate DSM prudency requests by the utilities. Because the MOU agreement was not reached until the end of 2009, it contained language indicating Staff would allow reasonable leniency for reporting DSM program evaluations through 2009. The MOU also contained specific language allowing Avista Utilities to re-file its 2008 DSM prudency request without Staff opposition.

Q. Please describe Avista's progress in its DSM evaluation and reporting since the MOU was signed.

A. As a result of the Commission deferring Avista's request for a DSM prudency finding in Case Nos. AVU-E-09-01 and AVU-G-09-01, the aforementioned MOU, and similar DSM evaluation questions being raised in a Washington Utilities and Transportation Commission docket, Avista formed a collaborative process to examine DSM evaluation and low-income program issues. As part of this effort, the Company has been diligently working on a comprehensive DSM Evaluation, Measurement and Verification (EM&V) Framework