DAVID J. MEYER
VICE PRESIDENT AND CHIEF COUNSEL FOR
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
DAVID.MEYER@AVISTACORP.COM

RECEIVED
2011 JUL -5 AM 11:45
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-11-01 CASE NO. AVU-G-11-01 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 educational 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 schedules in this proceeding will cover the Company's proposed pro forma adjustments for capital investments in utility plant for the 2010 test period.

Q. Are you sponsoring any exhibits?

A. Yes. I am sponsoring Exhibit 11, Schedules 1 through 3 which were prepared under my direction, and have been included to provide supporting information for the pro forma capital investment costs as described in this testimony.

II. CAPITAL INVESTMENT RECOVERY

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

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 (AMA) for the twelve months ended December 31, 2010. Adjustments[1] were made to reflect certain capital additions, as described in detail below:

(1.) An adjustment was made to record capital at December 31, 2010, together with the associated accumulated depreciation and deferred federal income taxes at a 2010 end-of-period (EOP) basis. This adjustment includes

[1] Company witness Ms. Andrews incorporates the Idaho share of the adjustments in her revenue requirement calculation.

annualizing the associated depreciation expense on the plant-in-service at December 31, 2010.

(2.) An adjustment was also made to reflect all 2011 capital additions (excluding distribution related capital expenditures made that are associated with connecting new customers to the Company's system) together with the associated accumulated depreciation and deferred federal income taxes at a 2011 EOP basis. This adjustment included associated expenses (depreciation expense and property taxes) and offsets to expenses for the pro forma additions. These specific capital additions are identified later in my testimony. In addition, the plant-in-service at December 31, 2010 was adjusted to a 2011 EOP basis.

(3.) An adjustment was also made to reflect all 2012 capital additions (excluding distribution related capital expenditures made that are associated with connecting new customers to the Company's system) together with the associated accumulated depreciation and deferred federal income taxes at a 2012 AMA basis. This adjustment included associated expenses (depreciation expense and property taxes) and offsets to expenses for the pro forma additions. These specific capital additions are identified later in my testimony. In addition, the plant-in-service at December 31, 2011 was adjusted to a 2012 AMA basis.

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 period that new retail rates from this filing will be in effect. In addition, the plant investment that was pro formed into this case was matched with offsetting factors. 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 those customers).

In the Idaho PUC's Order No. 29602, for 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, fair, and reasonable," 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.

Q. How are we assured that the capital additions pro formed in this case will actually occur for 2011 and 2012?

A. Many of the 2011 projects are already underway or completed either through actual construction, contracts signed, and /or materials ordered. In addition, the actual and planned capital expenditures for the utility for the years 2007 through 2010 are shown in Table 1 below. The table shows that actual capital expenditures have been very close to the planned expenditures on a consistent basis.

During the last two years the actual expenditures have been 98% to 99% of the planned expenditures. I believe it is fair to conclude that there is a high level of confidence that the planned capital expenditures for 2011 and 2012, which the Company has pro formed into this case, will occur and it is reasonable for them to be included for recovery in retail rates.

Table 1

	Planned Expenditures ($millions)	Actual Expenditures ($millions)	Percentage of Planned (%)
2007	$183.6	$198.4	108%
2008	$194.2	$205.4	106%
2009	$202.0	$199.7	99%
2010	$210.0	$206.8	98%

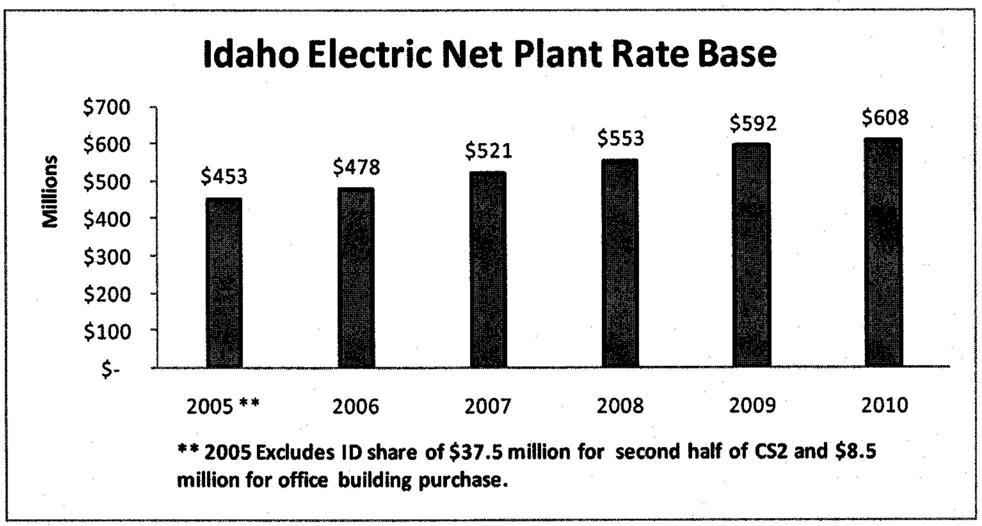
Q. How does new investment in utility plant change rate base over time for ratemaking purposes?

A. Historically (until roughly the last five years), the annual dollars spent by the Company on new utility plant was relatively close to the level of depreciation expense, with the exception of years where the Company invested in major new generating projects.[2] Net rate base stayed at a relatively constant level and the use of the rate base amount from a prior year, <u>i.e</u>., a historical test year, would be adequate for setting rates for the upcoming year, because there was little change in the <u>net</u> plant investment used to serve customers.

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

In more recent years, however, Avista's investment in utility plant has significantly exceeded depreciation expense. Because of this, rate base in the rate year is significantly greater than the historical test period AMA rate base. This is shown in Illustration 1 below.

Illustration 1



The only way to ensure that retail rates are just, fair, and reasonable is for the utility plant investment that is being used to serve customers be properly reflected in retail rates, net of appropriate offsets. This makes it necessary for the Company to pro form plant investment that is in service after the historical test year, and will be in service during the rate year so that rate base for the pro forma rate year is representative of the level of investment used to serve customers. The Company's pro forma adjustments in this case properly reflect any offsets, and include adjustments to ensure a proper matching with test period loads.

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

A. Avista's annual capital requirements have steadily increased from approximately $130 million in 2005 to approximately $250 million in 2011. Capital expenditures of approximately $482 million are planned for 2011-2012 for customer growth, investment in generation upgrades and transmission and distribution facilities, as well as necessary maintenance and replacements of our natural gas utility systems. Capital expenditures of approximately $1.2 billion are planned for the five year period ending December 31, 2015. Schedule 1 of Exhibit 11 reflects this trend that Avista has experienced and what is planned for in the near future.

Q. What is driving the significant investment in new utility plant?

A. As Company witnesses Mr. Kinney and Mr. Lafferty, in particular, explain in their testimony, the Company is being required to add or upgrade new generation facilities, expand transmission and distribution facilities due in part to customer growth in our service area, reliability requirements, and needed capacity upgrades. Other issues driving the need for capital investment include an aging infrastructure, physical degradation, and municipal compliance issues (e.g., street/highway relocations), etc.

While the price escalation experienced in recent years for the cost of materials (concrete, copper, steel, etc.)

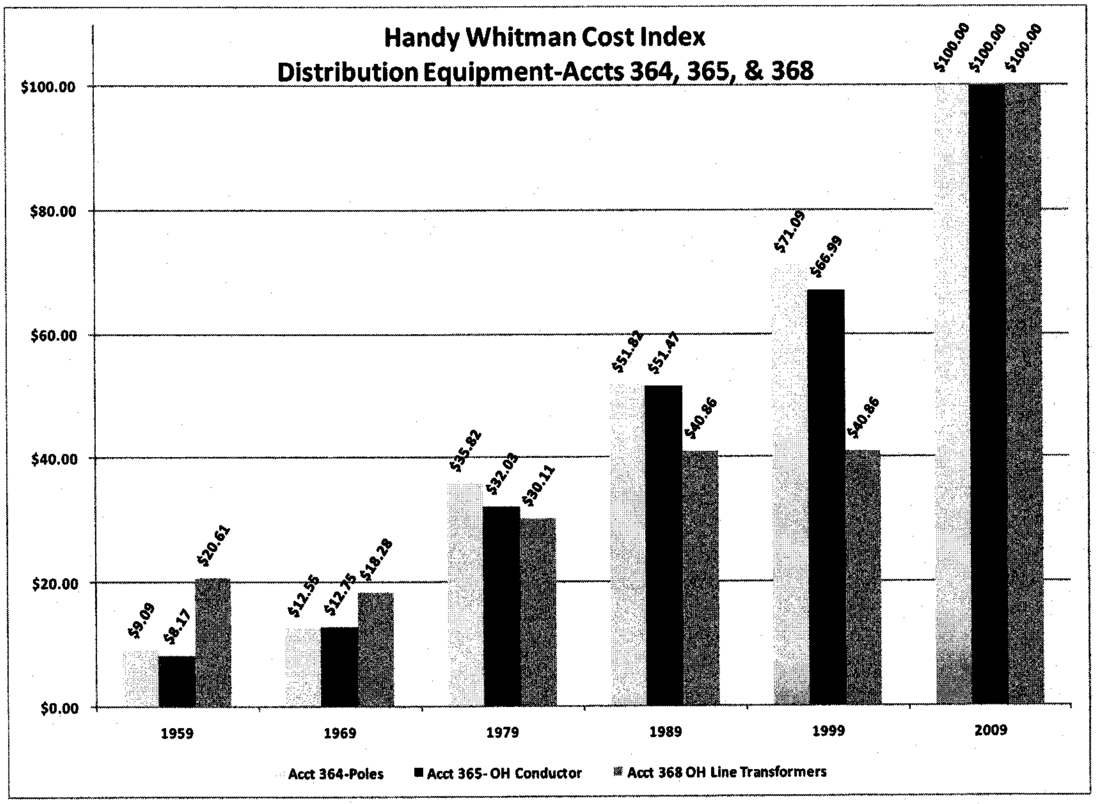
has subsided, the cost of materials and equipment is still orders of magnitude higher than what they were even a few years ago, causing the cost of these new facilities to be significantly higher than in the past. Accordingly, the annual costs associated with the new facilities will be significantly higher than the annual costs of the Company's facilities that are being replaced or upgraded.

Q. What data is available that depicts the significant increase in the cost of utility plant assets that have been added in recent years as compared to the cost of the facilities being replaced?

A. Using the Handy-Whitman Index Manual[3], the Company analyzed several major categories of plant. Schedule 2 of Exhibit 11 depicts the increases in costs of transmission substations, transmission equipment, distribution substations, and distribution equipment that the utility industry has experienced over the past fifty years. These charts show what these categories of plant have cost historically on a relative scale. For example, on Page 4 of Schedule 2, and also shown in Illustration 2 below, distribution poles fifty years ago would have a cost of only 9% of the current replacement cost.

[3] "The Handy-Whitman Index of Public Utility Construction Costs", published by Whitman, Requardt and Associates, Baltimore, Maryland. The Handy-Whitman Indexes of Public Utility Construction Costs show the level of costs for different types of utility construction. Separate indices are maintained for general items of construction, such as reinforced concrete, and specific items of material or equipment, such as pipe or turbo-generators. Handy-Whitman Index numbers are used to trend earlier valuations and original cost at prices prevailing at a certain date.

Illustration 2



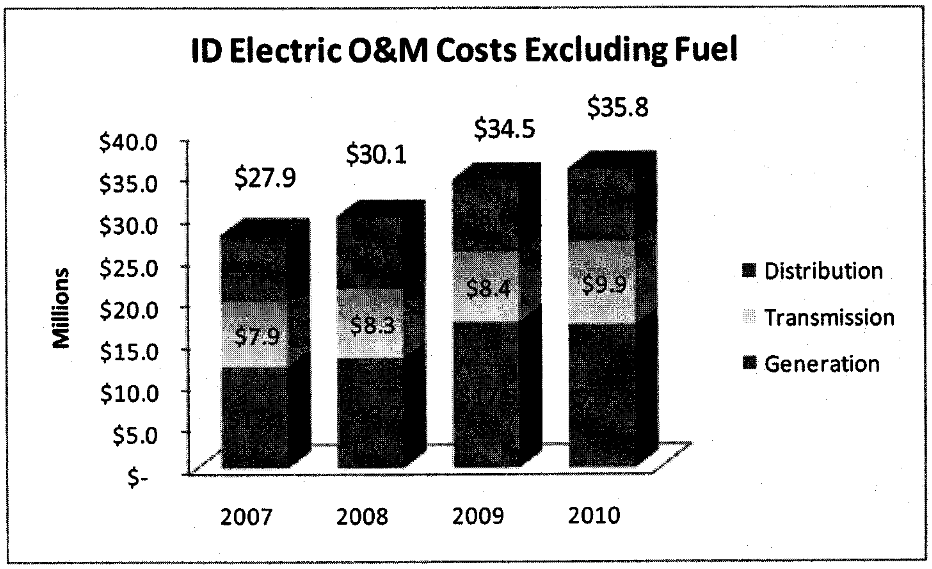
The chart above, and those on Schedule 2, show that the cost of the same equipment and facilities that are being added today are multiple times more expensive than those facilities installed in the past. Our retail rates are "cost-based" and reflect the low cost of the old equipment serving customers, when the equipment is replaced, it requires an increase in rates to reflect the much higher cost of the new equipment.

Q. With respect to Avista's proposed pro forma capital additions, would there be some operation and maintenance (O&M) savings associated with the replacement of some of the aging equipment with new equipment?

A. Not when you look at the total utility as a whole, which is how ratemaking is done.[4]

On a net basis, we will continue to experience O&M costs to maintain a system that continues to age. Our O&M costs are continuing to go up over time, not down, as shown in Illustration 3 below.

Illustration 3



At some point our facilities approach the end of their useful lives and need to be replaced before they fail. Our general practice is to attempt to replace our aging equipment before it fails, because it is not only less costly to replace this equipment on a structured, planned basis, but it also results in more reliable service to

[4] As described below, all of the capital that was pro formed was reviewed for any offsets and any specific offset that was identified was included in the filing as a separate restating adjustment (O&M Savings Adjustment) as a reduction to O&M costs.

customers, which is expected by all utility stakeholders. If our practice were to avoid replacing utility equipment until it failed, the reliability of our system would suffer.

Therefore, it is imperative that we continue every year to reinvest and upgrade a portion of our utility system, in addition to the investments to meet mandatory reliability requirements, so that our system will continue to provide reliable service.

The reinvestment and upgrades actually serve, to a large extent, to allow the Company to avoid additional costs in the future associated with maintenance - not to reduce the overall level of existing O&M costs. Mr. Kinney provides additional testimony in this area.

III. DESCRIPTION OF CAPITAL PROJECTS

Q. Please provide a listing of the 2011 capital projects that were pro formed in this filing.

A. Exhibit No. 11, Schedule 3, Page 1, details the capital projects that will be transferred to plant in service in 2011 and included in this filing. A listing and/or description of the capital projects and their system costs that will transfer to plant in service in 2011 and that are included in this filing follows:

Generation ($25.280 million - system):

The electric generation projects that will transfer to plant in service are described in detail in Mr.

Lafferty's direct testimony. A listing of these projects follows:

Thermal - Kettle Falls Capital Projects - $731,000
Thermal - Colstrip Capital Projects - $6,926,000
Thermal - Other Small Capital Projects - $156,000
Hydro - Cabinet Gorge Upgrade - $800,000
Hydro - Noxon Capital Projects - $1,000,000
Hydro - 2011 Noxon Unit #2 Upgrade - $9,110,000
Hydro - Clark Fork PME Agreements - $1,468,000
Hydro - Spokane PME Agreements - $2,243,000
Hydro - Other Small Capital Projects - $1,874,000
Other - CS2 Capital Projects - $630,000
Other - Other Small Generation Projects - $342,000

Electric Transmission ($26.959 million - system):

The electric transmission projects that will transfer to plant in service are described in detail in Mr. Kinney's direct testimony. A listing of these projects and system costs follows:

<u>Reliability Compliance Projects</u>:
Spokane-CDA 115 kV Line Relay Upgrades - $1,000,000
SCADA Replacement - $625,000
System-Replace/Install Capacitor Banks - $400,000
Moscow Sub Rebuild - $400,000
Bronx Cabinet 115 kV Substation Rebuild - $2,000,000
West Plains Transmission Reinforcement - $2,300,000

<u>Environmental Regulation Project</u>:
Beacon Storage Yard Oil Containment - $1,020,000

<u>Contractual Required Projects</u>:
Colstrip Transmission - $533,000
Tribal Permits - $325,000

<u>Reliability Improvement Projects</u>:
Idaho Road Substation - $1,750,000
Hatwai - N. Lewiston 230 kV Re-Insulate - $250,000
12F2 & PVW 241 Feeder Tie - $265,000

<u>Replacement Transmission Projects</u>:
Power Transformer Transmission - $3,250,000
Transmission Minor Rebuilds - $2,750,000
Power Circuit Breakers - $1,600,000
Otis Orchards - 115 kV Breaker and Line Relay Replacement - $730,000
Noxon Rapids B Bank GSU Replacements - $5,874,000

<u>Transmission Asset Management Projects</u> - $1,887,000

Electric Distribution ($65.757 million - system):

The Idaho specific electric distribution projects totaling $9.465 million that will transfer to plant in service are described in detail in Mr. Kinney's direct testimony. A listing of these projects follows:

Power Transformer Distribution - $350,000
Appleway Substation Rebuild - $4,200,000
Deary Substation Rebuild - $1,615,000
System-Dist Reliability-Improve Feeders - $925,000
12F2 & PVW 241 Feeder Tie Distribution - $360,000
CDA East & North - Pullman & Lewis Clark - $1,025,000
Replace High Resistance Conductor - $615,000
PCB Related Distribution Rebuilds - $375,000

The electric distribution projects totaling $24.1 million (system) that will transfer to plant in service are described in detail in Mr. Kinney's direct testimony. A listing of these projects follows:

Electric Distribution Minor Blanket - $8,000,000
Wood Pole Replacement Program & Capital Distribution Feeder Repair - $8,900,000
Electric Underground Replacement - $3,500,000
Distribution Line Relocation - $1,700,000
Failed Electric Plant - $2,000,000

The following electric distribution projects included on Exhibit No. 11, Schedule 3, are specific to the Washington jurisdiction and are not included in the Idaho electric revenue requirement in this case.

Power Transformer Distribution - $1,000,000
Replace High Resistance Conductor - $1,876,000
PCB Related Distribution Rebuilds - $2,125,000
Distribution Projects in Washington - $8,700,000
Washington Smart Grid Distribution - $18,461,000

General ($18.003 million - system):

Security Initiative - $374,000
Various security measures including cameras and access controls for the office and branch facilities.

Structures and Improvements - $3,500,000
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 2011, planned projects include: roof replacements, HVAC

system replacement at some branch offices, energy efficiency window and lighting projects, security projects, asphalt overlays and replacement, as well as some capital repair projects in existing buildings.

Stores Equipment - $402,000
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 - $1,300,000
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.

HVAC Renovation Project - $5,541,000
The heating, ventilating, and air conditioning systems throughout the Spokane Central Operating Facilities are approximately fifty years old and are in need of replacement. In 2007, the Company initiated a multi-year HVAC renovation project that 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 was also renovated with high efficiency glass and insulation. The project will also achieve asbestos abatement and life safety (fire sprinkler) additions. New controls will also be installed which will enable energy conservation. Present estimates indicate cost savings of approximately $430,000 per year in energy use, a 36% reduction in energy costs once all phases have been completed, currently planned to be completed in 2013. The 2011 project pro formed into this case will produce approximately $31,000 per year (system) in reduced energy costs, which have been pro formed as a reduction to O&M costs. The Company has included an additional $31,000 in O&M savings related to the 2010 portion of this capital project that was completed in late-2010.

WSDOT Highway Preservation/Maintenance of Right of Ways - $350,000
In order to operate our electric system within State highway rights of way, the Company needs to preserve/maintain right of ways. Existing right of ways have expired and Avista must seek new agreements with the State or risk penalties or non-approval by the State.

Colville Service Center - $5,400,000
The construction of a new service center was specific to the Washington jurisdiction and has not been included in the Idaho electric revenue requirement in this case.

Other Small Projects - $1,136,000
These projects include office furniture additions and replacements, communication and security initiatives, radio equipment, telephone systems, office and other general facility upgrades.

Transportation ($9.468 million - system):

Transportation Equipment - $9,468,000
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. This also includes additions to the fleet for new positions or crews working to support the maintenance and construction of our electric and natural gas operations.

Technology ($24.073 million - system):

Information Technology Refresh Blanket - $8,995,000
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 - $1,180,000
A program to deliver technology associated with expansion of existing solutions.

Avista Facility Management (AFM) Product Development Program - $640,000
Deliver enhancements to the electric and natural gas Facility Management technology system.

Nucleus Product Development Program - $480,000
Deliver enhancements to the Nucleus energy resource management technology system.

Web Product Development Program - $960,000
A program to deliver enhancements to the Customer based Web technology system.

Business Application Refresh Program - $1,188,000