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AVISTA Corp.

September 1, 2009

Public Utility Commission of Oregon
Attn: Filing Center
PO Box 2148
Salem, OR 97308-2148

Advice No. 09-03-G

RE: Docket No. UG-186 –Supplemental Direct Testimony of Dave DeFelice

Pursuant to the Proposed Information Request submitted by the Citizens' Utility Board of Oregon (CUB) in the above referenced matter, enclosed for filing by Avista Corp., dba Avista Utilities are an original and 25 copies of the supplemental direct testimony of Dave DeFelice.

Please direct any questions regarding this filing to Liz Andrews at (509) 495-8601.

Sincerely,

Kelly Norwood

Kelly O. Norwood
Vice President, State and Federal Regulation

Enclosure

c: See attached service list

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served Avista's Supplemental Direct Testimony of Dave DeFelice in Docket UG-186, upon the parties listed below by mailing a copy thereof, postage prepaid and/or by electronic mail.

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I declare under penalty of perjury that the foregoing is true and correct.

Dated at Spokane, Washington this first day of September 2009.

Patty Olsness
Patty Olsness
Rates Coordinator

BEFORE THE
PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UG-186

SUPPLEMENTAL DIRECT TESTIMONY OF DAVE B. DEFELICE
REPRESENTING THE AVISTA CORPORATION

Capital Projects

September 1, 2009

Q. Are you the same Dave B. DeFelice who testified in this proceeding?

A. Yes, I am.

Q. What is the scope of your supplemental testimony?

A. My supplemental direct testimony responds to the Proposed Information Request submitted by the Citizens' Utility Board (CUB) of Oregon. The Proposed Information Request requested that Avista provide information regarding the timing of rate base additions, specifically addressing "used and useful as related to the commencement of the test year".

Q. What was the test year the Company utilized for this general rate proceeding?

A. The forecasted test period used by the Company is the twelve months ended December 31, 2010, presented on a forecasted basis.

Q. Why did the Company use the year ending December 31, 2010 as the test period?

A. The forecasted test period in this case was selected to best reflect the conditions during which time the new rates will be in effect. Rates from this proceeding will be effective in the first half of 2010, which closely matches the forecasted test period used by the Company in the calculation of the revenue requirement. The revenue requirement was based on revenues using the forecasted 2010 test period projected customer usage and forecasted 2010 costs.

Q. How was rate base for the forecasted test year developed for this filing?

A. Adjustments were made to the plant in service at December 31, 2008 to accumulated depreciation and deferred federal income taxes (DFIT) to restate to the average of monthly averages (AMA) amounts for the twelve months ended December 31, 2010. In addition, adjustments were made to reflect 2009 and 2010 plant additions and associated accumulated depreciation and DFIT through December 2010 on an AMA basis. However, three major plant additions for 2010, including the East Medford Reinforcement Project, the Roseburg Reinforcement Project and the Grants Pass Reinforcement Project were reflected on and end of period basis.[1] Subsequent to Avista's original filing in this case, the Company reevaluated the East Medford and Roseburg Reinforcement Projects and moved the projects to 2011, therefore, these projects should be removed from this case as described below.

Q. Please summarize the capital projects that the Company pro formed into this case?

A. As described in my direct testimony submitted with the original filing, Avista pro formed $17.819 million of Oregon natural gas distribution capital expenditures and $3.2 million of Oregon's share of general plant capital expenditures that will be completed in 2009. (See Tables 1 and 2 on page 4 of Exhibit 400/DeFelice for detailed listing of projects.) All of these projects will be completed and will be in-service during 2009. In addition, the Company pro formed $19.222 million of Oregon natural gas distribution capital expenditures and $2.5 million of Oregon's share of general plant capital expenditures that will be completed in 2010. (Also see Tables 1 and 2 on page 4 of Exhibit 400/DeFelice for detailed listing of projects.) Company witness Andrews' workpapers detail all of the capital projects that were pro formed in this case, including the date the project will be in-service. By using AMA basis for all plant, with the exception of the plant described above that used end of period basis, the pro forma depreciation expense and the pro forma rate base reflects the timing of the additions to plant as it is expected

[1] The effect of end of period basis reflects the depreciation expense and plant rate base for a full year.

to occur in 2010.

Q. Why did the Company use the 2010 AMA rate base in this case?

A. The 2010 AMA rate base reflects the net plant in service that will be used to serve customers during the 2010 forecasted test year, and is consistent with the use of 2010 forecasted revenues and expenses. 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 used to serve customers.

Q. Does the use of <u>average rate base</u> in a forecasted test period help ensure that capital expenditures and customer usage are appropriately matched through the effective rate year?

A. Yes. The "test year" should reflect costs and revenues that will fairly represent the period when prices from the docket will be in effect following a general rate case proceeding. For capital expenditures, the test year rate base reflects the average effect of closing the capital expenditures to plant in service over the course of the year. Because capital expenditures are recorded as plant-in-service at a particular point in time, the component parts of rate base will change over the course of the test year as new capital expenditures close to plant-in-service throughout the year.

Because prices are set for the entire duration of the rate year, there will inevitably be certain timing differences within the year between capital expenditures and pricing to customers. Customers paying for service early in 2010 will be paying prices that include costs for some capital expenditures that do not close to plant until later that year. On the other hand, customers paying for service in December will be paying prices less than the cost for the capital expenditures that close to plant-in-service during the previous 11 months of 2010. The use of average rate base helps ensure that such timing differences throughout the year are roughly balanced and do not cause undue intergenerational inequities during the test year, or result in over-recovery or under-recovery of costs.

If only capital projects that were in service at the date new rates are set are included, it would essentially require daily or monthly pricing to ensure that customers pay for capital expenditures that are used to provide service at each point in time within the test year. Of course, this would be unworkable and would be inconsistent with the use of test years to set prices.

Q. ORS 757.355 states "a public utility may not, directly or indirectly, by any device, charge, demand, collect or receive from any customer rates that include the costs of construction, building, installation of real or personal property not presently used for providing utility service to the customer." Does this mean that there is legal prohibition against including costs of any capital expenditures not in service when rates go into effect in customers' rates?

A. No. Ballot Measure 9, codified as ORS 757.355, applies only to new facilities and does not apply to capital improvements to existing facilities that are currently used and useful, like the capital improvements included in this docket. See UM989, Order No. 02-227 ("ORS 757.355 does not apply to routine construction work in progress (CWIP) attached to an operating plant. Ballot Measure 9, codified as ORS 757.355, was intended to apply to CWIP that reflects preconstruction commercial operating plants, not smaller projects attached to an operating plant").

Q. Are the 2010 capital projects that the Company pro formed into this case

routine construction work that is attached to existing operating plant?

A. Yes, all of the 2010 projects pro formed in this case are work on existing operating plant. Avista currently has natural gas infrastructure that is being used to provide service to customers. The 2010 capital additions are either expansions or upgrades to this existing plant. None of this work represents costs on preconstruction operating plant.

Q. If rates go into effect on January 1, 2010, does including transfers to plant in service after that date in customers' rates violate the matching principle?

A. No. Since the Company is proposing rates be set according to a forecasted test-year, which includes the level of revenues expected from a population of customers in 2010 and for a level of expenses forecasted for 2010, it would require that the capital expenditures transferred to plant in service in 2010 be included. To <u>exclude</u> the 2010 capital expenditures would violate the matching principle in relation to the 2010 revenues and expenses filed by the Company. In addition, the exclusion of the 2010 capital expenditures would not allow the Company to earn a fair return on its investment.

Q. How is the Company negatively impacted if the proposed capital expenditures for 2010 are not included in customers' rates during the 2010 rate year?

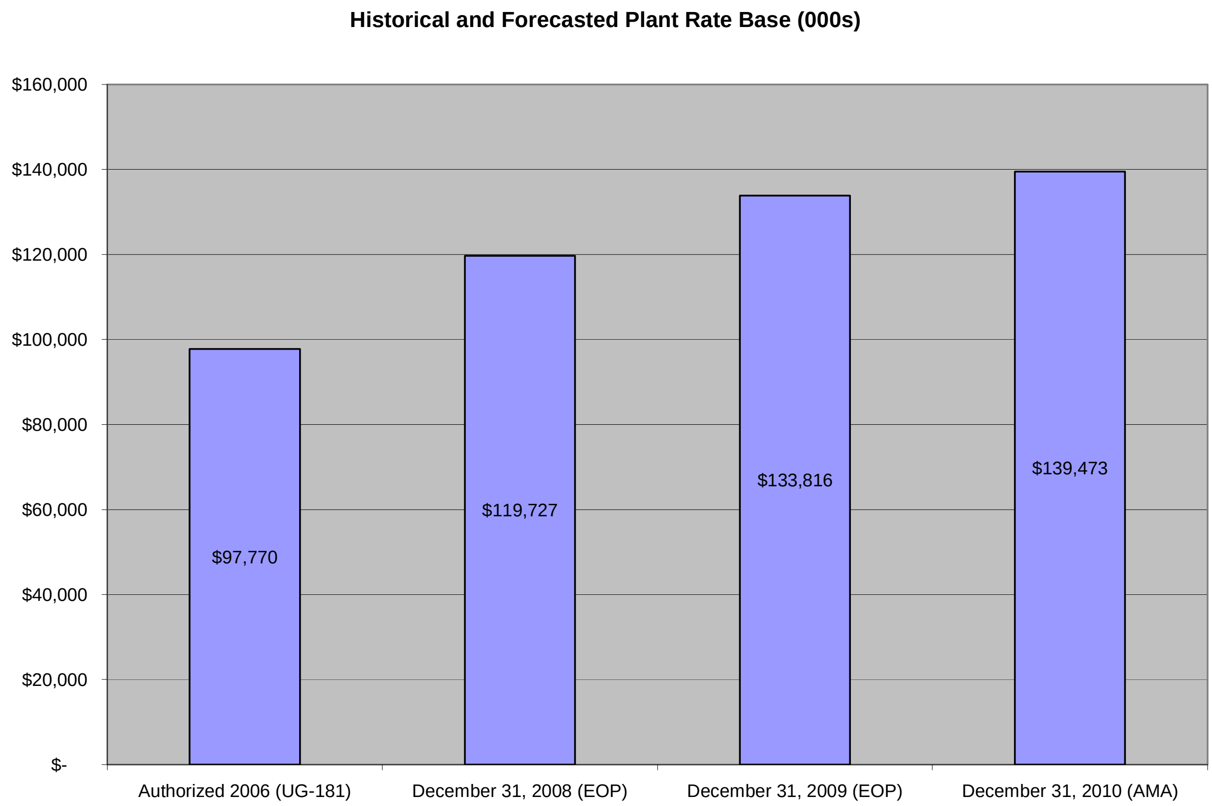
A. Since new investment in utility plant is increasing rate base over time for ratemaking purposes, there would be a mismatch if future revenues were based upon depreciation expense and the level of capital expenditures in a historical year.

I will use an example to illustrate, in general terms, how new investment in utility plant changes rate base over time. Let's assume that the Company's rate base (adjusted net plant in service used to serve customers) at the beginning of Year 1 is $100 million. Also assume that depreciation expense in Year 1 is $6 million, and the Company's new investment in utility plant in Year 1 is also $6 million. During Year 1, rate base increased by $6 million (new plant investment), and decreased by $6 million (depreciation expense), and ended up at the same level of $100 million at the end of the year. In this simplified example, the Company's rate base is $100 million, both at the beginning of Year1 and at the end of Year 1.

For ratemaking purposes, the $100 million of rate base is representative of the level of plant investment necessary to serve customers, both at the beginning of the year and at the end of the year. Over time, if depreciation expense continues to be approximately equal to new plant investment, rate base would continue at a relatively constant $100 million. Under these circumstances, the use of $100 million rate base amount from a prior year, i.e., a historical test year, would be adequate for setting rates for the upcoming year (forecasted rate year), because there is little change in the net plant investment required to serve customers.

However, the Company's new investment in Oregon utility plant is far exceeding its annual depreciation expense which causes an increase in rate base from the historical year to the forecasted rate year. Table 3 from my direct testimony illustrates that Oregon's capital expenditures since 2005 have been steadily increasing from approximately $10 million to approximately $20 million a year in 2010. Depreciation expense for this time period has been approximately $6 million per year. Table 1 below illustrates the impact on rate base.

Table 1:



The rate base data above excludes inventory.
The 2010 plant rate base excludes $6.0 million for removing two projects, detailed below, from the orginal filing.

If the Company did not include the 2010 capital additions in this filing, customers would be paying for the plant rate base of $133,816,000, but receiving the benefit of the average rate base of $139,473,000.

Q. Are there any changes to be made to the Company proposed forecasted capital projects included in its direct filing?

A. Yes. Two reinforcement projects that were to be completed in 2010 have been reevaluated and will be completed in 2011. These two projects are the East Medford Reinforcement project and the Roseburg Reinforcement project.

As described in my direct testimony, the East Medford Reinforcement project was going to be completed in three phases when the original rate request was made, with the final phase completed in November 2010. The project schedule and spending are being modified consistent with Avista's Integrated Resource Plan (IRP). Preliminary indications from the IRP under development indicate that growth was not as significant as expected and, therefore, the requirement to complete the reinforcement is not as immediate. Phase I was completed (in 2008) and Phase II (2009 pro forma adjustment) will be completed as previously addressed in testimony. The previous Phase III (2010 pro forma adjustment) will be completed in multiple future projects. A portion of the third phase will be completed in 2010 coincident with road improvements along the route to reduce the overall project cost. The third phase, once completed, will loop the high pressure system on the east side of Medford by connecting Phase I and Phase II reinforcements. Phase III expenditures are currently estimated at approximately $600,000 and $4.1 million, and will be completed in November 2010 and November 2014, respectively.

Also described in my direct testimony, was the Roseburg Reinforcement project, which was to be completed in three phases over a four-year period. Phase I capital costs totaled approximately $1.893 million, were completed in September 2008 and were approved in Docket No. UG-181. Phase II capital costs were estimated at approximately $1.932 million, were to be completed in November 2010 and had been pro formed into this case. Phase III capital costs were estimated at approximately $3.4 million and were to be completed in October 2011.

Phases II and III have been deferred until 2011 and 2012, respectively. Roseburg's distribution system performance this past winter suggested that the Phase I reinforcement provided more pressure enhancement than had been expected. Further review by Avista's Gas Planner determined that delaying Phase II and III each by another year was prudent.

The Company computed the adjustment to remove $4.1 million of costs for the East Medford Reinforcement project and $1.932 million for the Roseburg Reinforcement project from the 2010 pro forma adjustment for these revisions to the plans. This change reduces the revenue requirement by approximately $1,037,000.

Q. Please summarize Avista's position regarding the capital rate base that was included in the Company's original filing.

A. Rates from this proceeding will be effective in the first half of 2010, which closely matches the forecasted test period used by the Company, and includes the forecasted revenues, costs and capital that will be in service during 2010. Including the costs associated with the Company's forecasted 2010 capital 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 used to serve customers. The plant will be used and useful during the rate year.

Q. Does this conclude your supplemental direct testimony?

A. Yes, it does.