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AVISTA Corp.

August 20, 2009

Public Utility Commission of Oregon
Attn: Vikie Bailey-Goggins
Administrative Regulatory Operations
550 Capitol St. N.E. Suite 215
Salem, OR 97308-2551

RE: UG171 – Rebuttal Testimony

Avista Corporation d/b/a/ Avista Utilities, hereby submits for electronic filing the Rebuttal Testimony. The original and five copies will be provided via overnight mail.

Sincerely,

David Meyer
Vice President and Chief Counsel
Avista Corporation
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David.Meyer@avistacorp.com

Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have served the Rebuttal Testimony in Docket UG 171, for Avista's 2007 Tax Report filing, by electronic mail, and by mailing a copy thereof where paper service has not been waived, to the following:

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Dated at Spokane, Washington this 20th day of August 2009.

Patty Olsness

Patty Olsness
Rates Coordinator

PUBLIC UTILITY COMMISSION OF OREGON

UG 171 (1) Phase II

AVISTA EXHIBIT 600

Rebuttal Testimony of Kelly Norwood On Behalf of Avista Corporation In the Matter of Avista's SB 408 2007 Tax Report

August 20, 2009

Q. ARE YOU THE SAME KELLY O. NORWOOD WHO TESTIFIED IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE SCOPE OF YOUR REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. My rebuttal testimony responds to the Opening Testimony of Staff of the Public Utility Commission of Oregon (Staff) and of the Joint Opening Testimony of the Citizens' Utility Board of Oregon (CUB) and the Northwest Industrial Gas Users (NWIGU) ("Parties"). In doing so, Avista provides this testimony to reassert its claim, filed on May 5, 2009, that implementation of the automatic adjustment clause (AAC), resulting in a refund of $2.4 million to customers, would result in confiscatory rates in violation of ORS 756.040, which requires that rates be just, reasonable and sufficient.

Q. DO YOU HAVE ANY INITIAL OBSERVATIONS RELATED TO THE TESTIMONY PRESENTED BY STAFF?

A. Yes. Staff presents two witnesses. Ms. Deborah Garcia addressed the review Staff conducted of Avista's earnings for the forecasted refund period. Mr. Steven Storm addressed whether Avista should provide a refund to customers from the perspective of whether doing so consistent with OAR 860-022-0041(10) would result in confiscatory rates. In summary, Ms. Garcia indicated that Staff agrees with Avista's representation of its estimated earnings for the refund period of June 1, 2009, through May 31, 2010. Mr. Storm acknowledges that, based upon the evidence presented, Avista's rates are confiscatory with the SB 408 refund and recommended the Commission not require Avista to provide an SB 408 refund based upon information known today.

Q. DO YOU HAVE ANY INITIAL OBSERVATIONS RELATED TO THE JOINT TESTIMONY PRESENTED BY CUB/NWIGU?

A. Yes. In their joint testimony, CUB/NWIGU suggest that the use forecasted results is not reliable since "other factors" could possibly influence earnings in the meantime, e.g., weather, economic activity, natural gas prices and hedging strategies, etc. According to their logic, the Commission should wait for all of these factors to play out, in addition to deciding Avista's recently filed General Rate Case (GRC) in Docket UG 186, to evaluate the Company's claim of confiscation. However, beyond speculation, they presented no credible evidence as to how these factors might actually play out in a manner that would avoid confiscatory rates.

Q. DO ANY OF THE PARTIES TAKE ISSUE WITH AVISTA'S 2008 ADJUSTED RESULTS OF OPERATIONS REPORT FOR PURPOSES OF ARRIVING AT PROJECTED RESULTS OF OPERATIONS FOR THE REFUND PERIOD?

A. No. In her pre-filed testimony, Ms. Garcia acknowledges that Avista filed "comprehensive workpapers" projecting its earnings for the refund period of June 1, 2009, through May 31, 2010. (Exhibit 200, p.2, ll. 9-17) For its part, Staff performed what it characterized as a "thorough review of the Test Period

ROO [Results of Operations] filing," which review included "multiple telephone conferences between Staff and Avista to answer Staff questions regarding Avista's methodology and calculations." (Id.) As a result, Staff agrees with Avista's representation of its estimated earnings for the refund period of June 1, 2009, through May 31, 2010, and found that ". . . Avista's use of its 2008 ROO with known and measurable adjustments to reflect normal ongoing operations is a reasonable approach for forecasting Test Period [refund period] earnings." (Id. at p.3, ll. 15-18)

While CUB/NWIGU believe there is uncertainty around prospective earnings, they state that they "do not dispute the outcomes shown in Ms. Pluth's modeling work (Exhibit 502) in which Ms. Pluth has calculated various implied returns on equity ranging from 3.78% to 5.94% if Avista's full UG 186 rate increase is granted."

Ms. Pluth's analysis assumed the entire request of $14.2 million was approved, including a ROE of 11.0%.[1] She also assumed that new rates would be implemented March 1, 2010, which is approximately two months earlier than the end of the suspension period of April 27, 2010.

Q. USING MS. PLUTH'S ASSUMPTIONS, WHAT WERE THE RESULTS?

A. Staff noted that Avista's own analysis assumed that Avista's entire request of $14.2 million in its pending GRC was approved, with a requested ROE of 11%; even doing so, Staff acknowledged that reflecting an additional three months of such revenues during the refund period from the GRC still

[1] Avista's current authorized ROE is 10.0%

only resulted in a 5.94% return on equity (ROE) prior to any refund, and a 3.78% ROE after a refund. (Id. at p.4)[2] As discussed below, Avista performed further analysis which varied the assumptions surrounding both the timing and the amount of general rate relief awarded in UG 186, and under every set of assumptions, a refund would result in confiscatory rates.

Q. WAS FURTHER ANALYSIS PERFORMED ASSUMING OTHER POSSIBLE OUTCOMES OF AVISTA'S PENDING GRC?

A. Yes. The Parties nevertheless contend that the resulting earnings, both with and without a refund, will be affected by both the magnitude and timing of any rate relief awarded Avista in UG 186. They suggest that it is possible, for example, for rate relief to be awarded prior to the end of the suspension period. To that end, Staff had requested Avista to calculate the impact of various levels of rate relief occurring as early as January 1, 2010 – nearly four (4) months prior to the end of the suspension period.[3] Staff Witness Garcia, in her pre-filed testimony, accepted the Company's calculations in that regard, which demonstrated that even with 100% of Avista's requested rate relief assuming a 10% ROE with rates effective January 1, 2010, Avista would only realize a 6.27% ROE after giving effect to the refund. (Staff Exhibit 200, at p.5, ll. 1-8) And, that return was on the high end. In the alternative, if only 50% of rate relief were awarded effective at the

[2] It should be noted that the Temporary Rule does not call for speculation concerning possible impacts of future rate relief.
[3] In its June 25, 2009 memo to the Commission recommending suspension of Avista's general rate filing in Docket No. UG 186, Staff argued that it needed the full nine-month suspension period (i.e. until April 27, 2010) "due to the size of the increase and the complexity of the case."

end of the suspension period, this would result in an ROE, after refund, of only 1.32%. As will be discussed below, this range of results of 1.32% to 6.27% is still well below what Staff Witness Storm implies to be a threshold level for confiscatory rates.

In his analysis, Mr. Storm assumes 100% of Avista's rate relief is made effective on April 25, 2010, resulting in a forecasted ROE of 3.86% without a refund, and 1.69% with a refund. (Staff Exhibit 300, at p.2)

Q. WHAT CONCLUSIONS WERE DRAWN BY MR. STORM FROM THIS ANALYSIS?

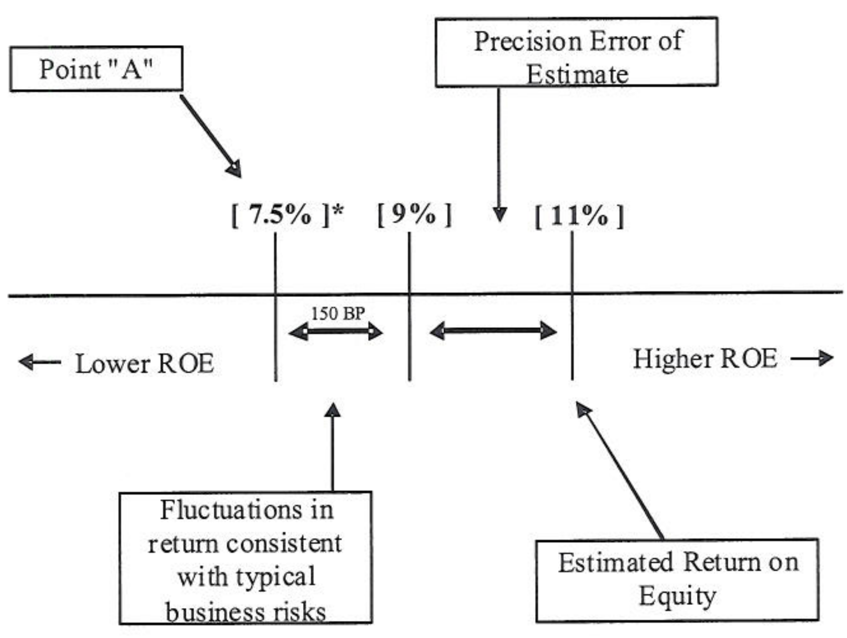
A. He appropriately attempts to place such returns into the broader perspective of what constitutes fair and reasonable returns, concluding that ". . . it is likely that Avista's current cost of equity is well above 3.86%." (Id. at p.4, ll. 15-17) In his pre-filed testimony, Mr. Storm states:

> From my review of past general rate case proceedings, recommended ranges of returns on equity typically span between 100 and 200 basis points. While an analyst might recommend a 10% return on equity, for example, the range of estimates may be from 9% to 11%. The "true" return investors require to hold Avista stock may be as low as 9% or as high as 11%. (Id. at p.4, l. 22 - p.5, l. 4)

To put this into further perspective, Staff Witness Storm noted that current returns on 10 and 30-year Treasuries which, in his words are "relatively riskless," have yields exceeding 3.86%; as of July 23, 2009, yields on 10 and 30-year Treasuries were 3.72% and 4.58%, respectively. (Id. at p.5, ll. 14-18)

Staff Witness Storm then further expanded his reasonable range of ROEs (9-11%) in order to encompass other business risk factors, analogous to the use of deadbands in power cost adjustments, where such deadbands have ranged from 100 to 150 basis points. (Id. at p.6, ll. 15-17) In his words, ". . . for purposes of establishing the threshold return on equity below which confiscatory rates begin, I think it is reasonable to expand the range somewhat beyond that which might encompass an estimated return on equity required by investors." (Id. at p.6, ll. 20-23) To that end, he sponsored the following chart appearing at page 7 of his testimony, to which has been added the figures discussed immediately above:

Excerpt from Staff Testimony
Describing ROE Ranges



Source: Storm Exhibit 300, Page 7
* Percentages added based on information provided in Staff Witness Storm's testimony (Exh. 300, Pages 5-7)

Accordingly, if one were to adjust Staff Witness Storm's 9-11% range of ROEs to account for "other factors" such as weather or changes in load based on economic activity, and widen it by an additional 100-150 basis points, this results in a range of ROEs from 7.5% to 12.5%, below which presumably confiscation would occur, at least according to Mr. Storm's own logic. Under <u>no scenario</u> involving the possible resolution of Avista's GRC, either in terms of magnitude or timing, does Avista's ROE, with a refund, fall within the <u>non</u>-confiscatory zone implied by Staff Witness Storm. Even with 100% of Avista's rate relief, using an ROE of 10.0%, occurring as early as January 1, it would only produce a return of 6.27%, after the refund. (Staff Exhibit 200, at p.5, ll. 1-3) If, on the other hand, the Commission were to award only 75% of Avista's requested rate relief, assuming a 10.0% ROE, at the end of the suspension period, its ROE would drop to 1.48%, after the refund.

Q. HOW ELSE COULD ONE COMPARE THE VARIOUS ROE'S THAT WERE COMPUTED USING THE VARIOUS OUTCOMES OF THE GRC?

A. By way of further perspective, it should be noted that Avista's current cost of debt is 6.92%. (Avista Exhibit 300, p.9, ll. 21-22) Company Witness Avera, in his pre-filed testimony observed:

> I have been involved in hundreds of rate cases and other regulatory proceedings since 1975. I cannot recall any witness (whether Company, Staff or Intervener) in any case involving an investor-owned utility recommending a fair ROE even as low as 6%, and certainly not at levels produced by the income tax refund in this case. Indeed, investors are requiring just under 5% to invest in 30-year U.S. Treasury Bonds, backed by the full faith and credit of the National Government with its power to tax

and print money. Similarly, the average yield on utility bonds rated Baa bonds (the same rating as Avista) averaged 7.76% in May 2009. (Exhibit 400, p.12, l. 19 - p.13, l. 8)

Finally, as noted by Company Witness Avera in his pre-filed testimony, it is well to remember that recently reported authorized ROEs for gas utilities in 2008 averaged 10.37% and 10.24% for the first quarter of 2009. (Id. at p.13, ll. 12-16)

Q. IS THERE A SUMMARY OF ALL ROE'S DISCUSSED ABOVE?

A. Yes. Attached as Exhibit 601 is a matrix showing ROE's resulting from a refund under every one of the eighteen (18) scenarios presented by the parties. Also page 2 of this Exhibit graphically illustrates that, under every scenario, Avista's returns would be at or below even its cost of debt, with a refund, and well below Mr. Storm's presumptive threshold for confiscation.

Q. CUB AND NWIGU ARGUE THAT 'OTHER FACTORS" CAN INFLUENCE A UTILITY'S PROSPECTIVE EARNINGS AND THEREFORE, THE COMMISSION MUST WAIT FOR ACTUAL RESULTS TO ANALYZE AVISTA'S CONFISCATORY RATE CLAIM. DO YOU AGREE?

A. No, I do not. It should be remembered that the analysis by Staff Witness Storm, discussed above, assigns 100-150 basis points of ROE to "other business risks," in order to evaluate a threshold for confiscation; this was analogous to a "deadband" of sorts. This would more than cover the host of "other factors" such as weather and economic activity that might affect earnings over the next several months.

Q. WHAT IMPACT COULD THE "OTHER FACTORS" DISCUSSED BY CUB AND NWIGU HAVE ON ROE?

A. A review of Avista's records over the last ten years reveal only one instance where weather-related usage increased by as much as nine percent (9%) in any calendar year. If that were to occur it would only impact Avista's ROE by approximately 1.3%.[4]

Similarly, an increase in economic activity and related load on Avista's Oregon system is not only highly unlikely between now and next May, but would have to occur at unprecedented levels to have any measurable impact. Actual usage levels for sales service for weather sensitive customers[5] has only increased from 76 million therms to 79 million therms from 1999-2008; it would have to increase by approximately 5 million therms between now and next May, in order to add sufficient margin to raise Avista's earned ROE by as much as 1%, as shown in Exhibit 602.

Similarly, references to the impact of natural gas prices and hedging strategies are also misplaced. Even under the 90/10 PGA sharing arrangements, the forecasted benefit during the refund period represents the Company's highwater mark in terms of its 10% share of PGA pricing changes, when it forecasts approximately $475,000 of after-tax benefits. This represents an improvement of its return by only 0.66% and <u>is already factored into the forecast of the refund period</u>. It should also be noted that the

[4] Even this assumes a full calendar year impact, as contrasted with any impact that may occur in the months prior to June of 2010.
[5] Weather sensitive customers include Schedules 410 and 420.

forecasted benefit is approximately a 100% increase over the highest actual annual benefit Avista earned in the past five years.[6]

Accordingly, the "other factors" referenced by CUB and NWIGU would not materially change the equation – even if they <u>all</u> coalesce in favor of Avista and defy expectations.

Q. CUB AND NWIGU REFERENCE OTHER "REMEDIES" THAT AVISTA MAY USE. PLEASE EXPLAIN WHY THESE ARE INSUFFICIENT.

A. CUB and NWIGU, in their pre-filed testimony, suggest that there are a "host of remedies" otherwise available to the Company, besides the withholding of the refund. (See Exhibit 100, p.7, ll. 3-11) They suggest that Avista could file a GRC (which Avista has done). They also infer that Avista might have done so earlier than it did; this ignores the fact that Avista was operating under the pre-existing rule, rather than the temporary rule, and could not have anticipated the adoption of such a rule in May of this year.

They also suggest that Avista could request some type of interim or emergency rate relief, in order to offset the impact of any refund. This, however, would not be the most efficient use of the resources of the Commission and the parties, if the net effect is to otherwise impose a refund obligation, but only to immediately offset it with a like portion of emergency or interim rate relief.

Finally, they suggest that the Company could somehow mitigate the impact by filing for "a deferral for particular discreet costs that have risen

[6] For the last 5 years, Avista's share of benefits/(costs) under the 90/10 PGA structure has been as follows: 2004 $0; 2005 ($42,000); 2006 ($96,000); 2007 $6,000; 2008 $243,000.

above the current costs in rates." (Id. at p.7, ll. 9-13) There is no such filing pending before the Commission and Avista currently has no plans for such a filing during the refund period.

Q. CUB AND NWIGU ARGUE THAT AVISTA'S EARNINGS WILL BE REESTABLISHED AT A REASONABLE LEVEL AT THE CONCLUSION OF THE RATE CASE, THEREFORE, THE REFUND'S ADVERSE EFFECT WILL BE TEMPORARY. DO YOU AGREE?

A. It is not the case that, by definition, the outcome of the rate case will produce "just and reasonable" rates, thereby essentially rendering moot any further discussion of the refund, as suggested by CUB and NWIGU. In fact, quite the opposite will occur: If the Commission establishes "just and reasonable" rates at the end of Avista's GRC process and then further orders a $2.4 million refund after setting such rates, Avista will, by definition, realize less than just and reasonable rates by the same $2.4 million. Following this line of reasoning, the only sensible solution is to add $2.4 million to the requested rate relief so rates remain just and reasonable.

Moveover, if the result is that confiscatory rate challenges are deferred to a pending or subsequent rate case – where presumably rates will be increased to a level that could better enable the utility to absorb the SB 408 refund (based on CUB and NWIGU's logic) – this could effectively eliminate a utility's ability to ever make a confiscatory rate challenge as a matter of procedure, even though the utility has already suffered the earnings impact of confiscatory rates (as has Avista during the tax year).

Q. WHAT IS YOUR CONCLUSION WITH RESPECT TO AVISTA'S 2007 SB 408 REFUND?

A. What Staff, CUB and NWIGU ignore is the fact that, under any possible range of outcomes from the rate case, the imposition of a refund will still result in confiscatory rates for the refund period. Nor will "other factors" (e.g., weather, economic activity) otherwise ameliorate the confiscatory impact of a refund.

As discussed above, sufficient, undisputed facts are now known that enable the Commission to decide the issue at this time, without further delaying the resolution of Avista's claim of confiscation. Indeed, Staff's own pre-filed testimony concludes that, if the Commission were to make its decision based on information known at this time, the Commission should not require Avista to provide an SB 408 refund in light of Avista's projected earnings during the refund period. (See Staff Exhibit 300 at p.3-4 (Storm)).

In sum, Staff acknowledges that, based upon the evidence presented, Avista's rates are confiscatory with the SB 408 refund. It is impermissible under ORS 756.040 to adopt procedures that thwart a utility's right to relief in such a case.

Q. DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?

A. Yes.

PUBLIC UTILITY COMMISSION OF OREGON

UG 171 (1) Phase II

AVISTA EXHIBIT 601

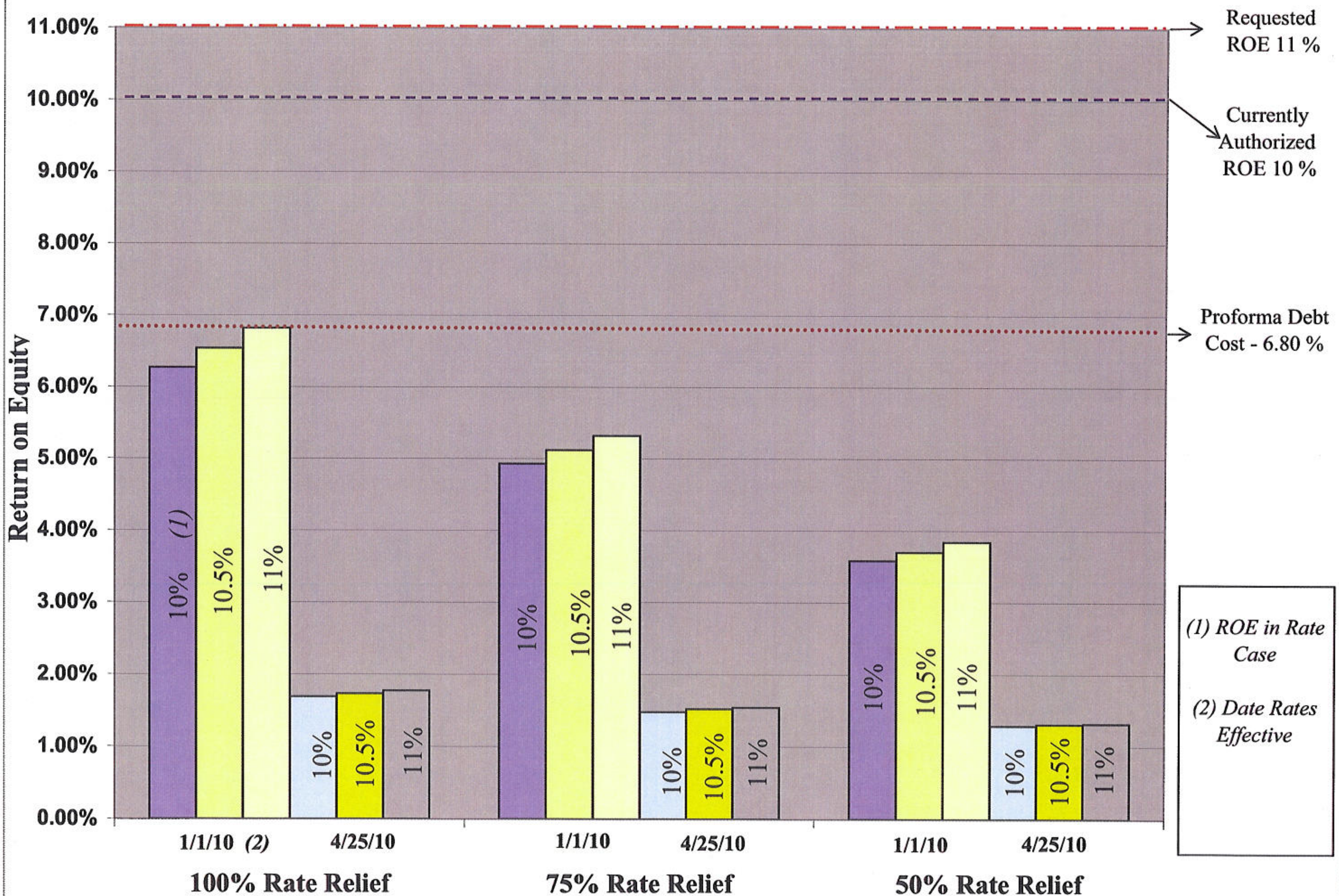
Exhibit of Kelly Norwood On Behalf of Avista Corporation In the Matter of Avista's SB 408 2007 Tax Report

August 20, 2009

Return on Equity with SB 408 Refund with Various Outcomes of the General Rate Case

	ROE in GRC	Effective Date of New Rates	Rate Relief Awarded 100%	75%	50%
Currently Authorized	10.0%	January 1, 2010	6.27%	4.93%	3.58%
		April 25, 2010	1.69%	1.48%	1.29%
Requested by Staff	10.5%	January 1, 2010	6.54%	5.12%	3.70%
		April 25, 2010	1.73%	1.52%	1.31%
Filed in GRC	11.0%	January 1, 2010	6.82%	5.32%	3.84%
		April 25, 2010	1.77%	1.54%	1.32%

Avista Utilities Return on Equity (w/ Refund)



PUBLIC UTILITY COMMISSION OF OREGON

UG 171 (1) Phase II

AVISTA EXHIBIT 602

Exhibit of Kelly Norwood On Behalf of Avista Corporation In the Matter of Avista's SB 408 2007 Tax Report

August 20, 2009

Avista Corporation
Oregon Gas
Impact on ROE of Additional Net Income Derived from Weather-Related Therm Sales

Additional Net Income Calculation:		
Net Operating Income (NOI) per Therm	$	0.14737
Number of Therms		5,000,000
NOI	$	736,850

Impact on ROE of Increase in NOI:	
Net operating income	$736,850
Less cost of debt	0
Net operating income available for common equity	$736,850
Divided by rate base (below)	0.530%
Divided by common equity capital structure percentage	51.340%
Impact on Return on Common Equity	1.03%

Rate base	$138,964,381

AVISTA CORPORATION
Oregon Gas
Weather-Related Data
1999 - 2008

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Weather Adjustment Therms										
Schedule 410	(247,090)	(501,573)	1,392,471	(508,678)	3,440,211	4,361,435	2,351,354	1,807,816	(1,701,827)	(4,626,337)
Schedule 420	(28,509)	(62,201)	231,828	(260,774)	1,777,884	2,170,856	1,159,568	871,958	(869,854)	(2,381,877)
Total	(275,599)	(563,774)	1,624,299	(769,452)	5,218,095	6,532,291	3,510,922	2,679,774	(2,571,681)	(7,008,214)
Annual Billed Therms										
Schedule 410	48,082,885	47,694,617	45,749,086	46,740,904	45,906,168	47,104,244	49,334,797	49,257,514	49,288,053	50,560,635
Schedule 420	28,177,366	27,717,670	26,996,581	27,196,755	25,809,715	26,631,156	28,069,448	28,301,835	28,051,290	28,273,201
Sub-Total weather sensitive	76,260,251	75,412,287	72,745,667	73,937,659	71,715,883	73,735,400	77,404,245	77,559,349	77,339,343	78,833,836
Total Oregon Billed Therms	151,296,462	150,487,231	129,400,722	137,081,828	130,689,663	134,834,305	135,824,545	125,019,406	119,109,996	118,337,977
Weather Adjustment NOI impact	$ (45,419)	$ (64,683)	$ 187,823	$ (82,782)	$ 687,307	$ 983,752	$ 529,736	$ 403,028	$ (377,447)	$ (1,032,793)
Weather Adj as % of WS Billed Therms	-0.4%	-0.7%	2.2%	-1.0%	7.3%	8.9%	4.5%	3.5%	-3.3%	-8.9%
NOI per Therm	$ 0.16480	$ 0.11473	$ 0.11563	$ 0.10759	$ 0.13172	$ 0.15060	$ 0.15088	$ 0.15040	$ 0.14677	$ 0.14737