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IDAHO PUBLIC
UTILITIES COMMISSION

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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-10-01
CASE NO. AVU-G-10-01

DIRECT TESTIMONY
OF
DAVE B. DEFELICE

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 Dave B. DeFelice. I am employed by
5 Avista Corporation as a Senior Business Analyst. My
6 business address is 1411 East Mission, Spokane, Washington.

7 Q. Please briefly describe your education background
8 and professional experience.

9 A. I graduated from Eastern Washington University in
10 June of 1983 with a Bachelor of Arts Degree in Business
11 Administration, majoring in Accounting. I have served in
12 various positions within the Company, including Analyst
13 positions in the Finance Department (Rates Section and
14 Plant Accounting) and in the Marketing/Operations
15 Departments, as well. In 1999, I accepted the Senior
16 Business Analyst position that focuses on economic analysis
17 of various project proposals as well as evaluations and
18 recommendations pertaining to business policies and
19 practices.

20 Q. As a Senior Business Analyst, what are your
21 responsibilities?

22 A. As a Senior Business Analyst, I am involved in
23 financial analysis of numerous projects within various
24 departments such as Engineering, Operations,
25 Marketing/Sales and Finance.

1 **Q. What is the scope of your testimony?**

2 A. My testimony and exhibits in this proceeding will
3 cover the Company's proposed pro forma adjustments for
4 capital investments in utility plant for the 2009 test
5 period.

6 **Q. Are you sponsoring any exhibits?**

7 A. Yes. I am sponsoring Exhibit No. 9, Schedules 1
8 through Schedule 3, which were prepared under my direction.

9

10

II. CAPITAL INVESTMENT RECOVERY

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

14 A. As in prior rate cases, Avista started with rate
15 base for the historical test year, which for this case is
16 the average of monthly averages for 2009. Adjustments were
17 made to reflect new additions and accumulated depreciation
18 through December 2010, such that the proposed rate base
19 reflects the net plant in service that will be used to
20 serve customers during the pro forma rate year. These
21 adjustments included associated expenses (depreciation
22 expense and property taxes) and offsets to expenses for the
23 pro forma additions.

1 Adjustments were also made to include the 2010 Noxon
2 Unit #3 generation plant upgrade and the 2011 Noxon Unit #2
3 generation plant upgrade.

4 The utility plant investment that we have included in
5 this filing represents utility plant that will be "used and
6 useful" in providing service to customers during the
7 approximate period that new retail rates from this filing
8 will be in effect. The costs associated with the
9 investment will be "known and measurable," and finally,
10 including the costs associated with this investment in
11 retail rates provides a proper "matching" of revenues from
12 customers with the costs associated with providing service
13 to customers (including the cost of utility plant to serve
14 customers).

15 In the IPUC's Order No. 29602, for Case Nos. AVU-E-04-
16 1 and AVU-G-04-1, dated October 8, 2004, the Commission
17 stated, at page 10, that:

18 Once a test year is selected, adjustments are
19 made to test year accounts and rate base to
20 reflect known and measurable changes so that test
21 year totals accurately reflect anticipated
22 amounts for the future period when rates will be
23 in effect. The Idaho Supreme Court has described
24 "rate base" as "the utility's capital investment
25 amount." *Industrial Customers of Idaho Power v.*
26 *Idaho PUC* 134 Idaho 285, 291, 1 P.3d 786, 792
27 (2000). Adjustments to test year accounts
28 generally fall into three categories: 1)
29 normalizing adjustments made for unusual
30 occurrences, like one-time events or extreme
31 weather conditions, so they do not unduly affect
32 the test year; 2) annualizing adjustments made
33 for events that occurred at some point in the

1 test year to average their effect as if they had
2 been in existence during the entire year; and 3)
3 known and measurable adjustments made to include
4 events that occur outside the test year but will
5 continue in the future to affect Company income
6 and expenses.
7

8 If utility plant investment that is being used to
9 serve customers is not reflected in retail rates then the
10 retail rates will not be "just, reasonable, and
11 sufficient," i.e., it would not be just or reasonable for
12 customers to receive the benefit provided by the utility
13 investment without paying for it, and the retail rates
14 would not provide revenues "sufficient" to provide recovery
15 of the costs associated with providing service to
16 customers.

17 **Q. Is the Company's application of these ratemaking**
18 **principles in this filing consistent with prior general**
19 **rate cases?**

20 **A. Yes. In prior cases, the objective has been the**
21 **same -- to include in retail rates the investment, or rate**
22 **base, that is providing service to customers, and ensure**
23 **that there is a proper matching of revenues and expenses**
24 **during the period that rates are in effect. In Case Nos.**
25 **AVU-E-09-01 and AVU-G-09-01, the Commission approved**
26 **including capital investment through December 31, 2009. In**
27 **this filing, we are requesting recovery of capital**
28 **investment through December 31, 2010.**

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

3 A. Historically, the annual dollars spent by the
4 Company on new utility plant were generally relatively
5 close to the level of depreciation expense, with the
6 exception of years where the Company invested in major new
7 utility projects.¹ In those years, net rate base stayed at
8 a relatively constant level and the use of the rate base
9 amount from a prior year, i.e., a historical test year,
10 would be adequate for setting rates for the upcoming year
11 (pro forma rate year), because there was little change in
12 the net plant investment used to serve customers.

13 In more recent years, Avista's investment in utility
14 plant has significantly exceeded depreciation expense.
15 Because of this, rate base in the rate year is
16 significantly greater than the historical test period AMA
17 rate base. The only way to ensure that retail rates are
18 fair, just, reasonable, and sufficient is for the utility
19 plant investment that is being used to serve customers be
20 properly reflected in retail rates. This makes it
21 necessary for the Company to pro form plant investment that
22 is in service after the historical test year and will be in
23 service during the rate year so that rate base for the pro
24 forma rate year is representative of the level of

¹ Recognizing that a portion of the costs associated with certain capital additions are offset by additional revenues.

1 investment used to serve customers. The Company's pro
2 forma adjustments in this case properly reflect any
3 offsets, and include adjustments to ensure a proper
4 matching with test period loads.

5 **Q. How was rate base for the pro forma rate year**
6 **developed for this filing?**

7 A. As in prior rate cases, Avista started with rate
8 base for the historical test year, which for this case is
9 the average of monthly averages for 2009. Adjustments were
10 made to reflect new additions and accumulated depreciation
11 through December 2010. Adjustments were also made to
12 include the 2010 Noxon Unit #3 generation plant upgrade and
13 the 2011 Noxon Unit #2 generation plant upgrade. Later in
14 my testimony, I will provide the details of the adjustments
15 to rate base.

16 The recent rate case (Case Nos. AVU-E-09-01 and AVU-G-
17 09-01) concluded with new retail rates effective August 1,
18 2009. Recovery of costs associated with new capital
19 additions through December 31, 2009 was included in retail
20 rates. With regard to the proper matching of revenues and
21 expenses, it can be said that some of the new capital
22 through December 31, 2009 was not in place at the time new
23 retail rates went into effect on August 1, 2009. However,
24 it is also true that the costs of new capital already
25 added, and to be added, in 2010 is currently not recovered

1 in retail rates. Although we know that a perfect matching
2 of revenues and expenses would be difficult to achieve, it
3 is very important that, during this period of high capital
4 investment, retail rates reflect the true costs of
5 providing service to customers, in order to afford the
6 Company the opportunity to recover its costs and continue
7 to attract capital under reasonable terms.

8 With regard to the current filing, Avista is hopeful
9 that new retail rates from this case will be effective in
10 the third quarter of 2010. Furthermore, new rates from the
11 next general rate case will likely not be effective until
12 sometime well into 2011. December 31, 2010 represents an
13 approximate mid-point of the period in which retail rates
14 would be in place from this case and the next case.
15 Including new capital investment through the mid-point of
16 the "rate year" will allow the Company the opportunity to
17 recover the costs associated with capital investment that
18 will serve customers over the course of the rate year.

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

21 A. As Company witnesses Mr. Kinney and Mr. Storro
22 explain in their testimony, the Company is being required
23 to add significant new generation, transmission and
24 distribution facilities, including strengthening the
25 backbone of our system, due in part to customer growth in

1 our service area, reliability requirements, and needed
2 capacity upgrades. Other issues driving the need for
3 capital investment include an aging infrastructure,
4 physical degradation, and municipal compliance issues
5 (e.g., street/highway relocations), etc.

6 While the rate of increases experienced in recent
7 years for the cost of materials (concrete, copper, steel,
8 etc.) has diminished, they are still orders of magnitude
9 higher than what they were even a few years ago, causing
10 the cost of these new facilities to be significantly higher
11 than in the past. Because the cost of adding new
12 facilities is significantly higher than the original cost
13 of our older, existing facilities, the investment in new
14 facilities will be significantly higher than the annual
15 depreciation expense on the Company's older, existing
16 facilities.

17 **Q. What is causing the substantial increase in raw**
18 **materials for Avista, and the utility industry in general?**

19 A. The Edison Foundation commissioned a study from
20 The Brattle Group, dated September 2007, titled, "Rising
21 Utility Construction Costs: Sources and Impacts," which
22 identified cost trends specifically related to the utility
23 industry pertaining to critical materials and equipment, as
24 well as labor support services used for building capital
25 infrastructure (a copy is included in my workpapers.)

1 Although the study is over two years old, we believe the
2 changes in costs described in the study are still
3 indicative of the increase in costs the utility industry
4 has experienced in recent years, and continues to
5 experience. The study identifies the reasons for dramatic
6 cost increases in critical raw materials, including global
7 competition for materials and an aging domestic utility
8 infrastructure, as well as the need for additional
9 infrastructure to accommodate growth in the near future.

10 **Q. What are some of the key cost drivers that are**
11 **cited in the study?**

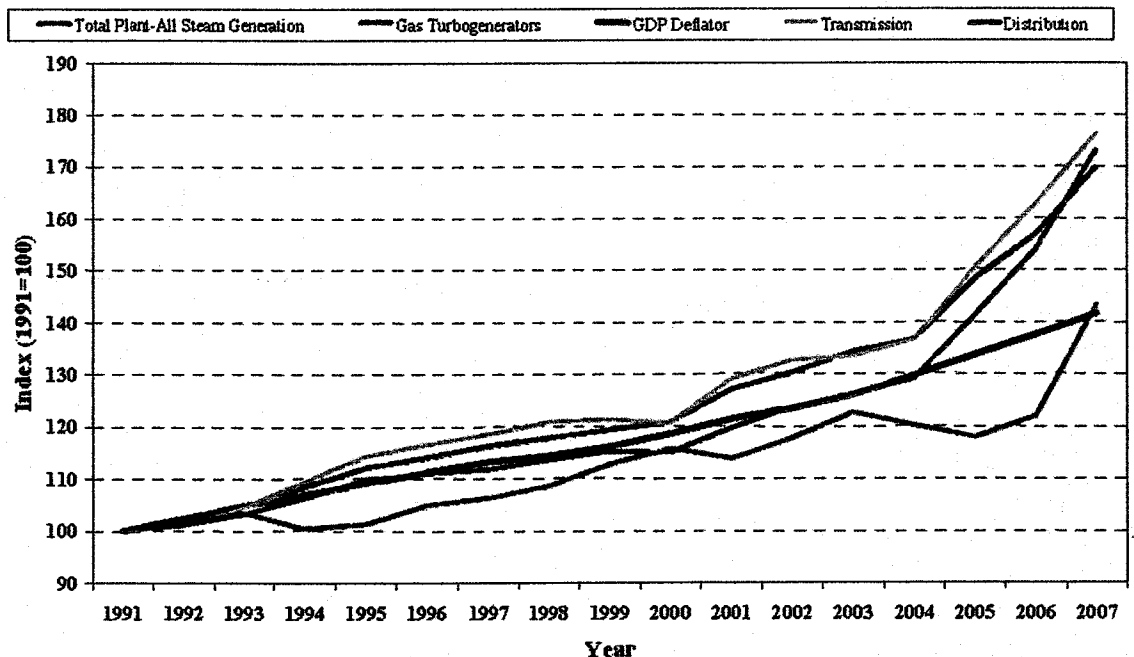
12 A. The study, at page 16, cites four major cost
13 drivers: "(1) material input costs, including the cost of
14 raw physical inputs, such as steel and cement as well as
15 increased costs of components manufactured from these
16 inputs (e.g., transformers, turbines, pumps); (2) shop and
17 fabrication capacity for manufactured components (relative
18 to current demand); (3) the cost of construction field
19 labor, both unskilled and craft labor; and (4) the market
20 for large construction project management, i.e., the
21 queuing and bidding for projects." The study goes on to
22 compare cost trends for various raw materials, critical
23 equipment and labor services relative to the general
24 inflation rate (GDP deflator). In addition, a cost trend
25 is summarized by three key utility functional plant

1 categories, including generation, transmission, and
2 distribution plant. The study concludes that these
3 inflation impacts have been outside the utility industry's
4 control and there are no immediate indications of cost
5 relief in the near future.

6 Illustration 1 below, excerpted from the Brattle Group
7 study, depicts what has occurred to infrastructure costs
8 nationally. From the chart, it is apparent that starting
9 in 2003, costs of distribution, transmission and generation
10 infrastructure increased at a far more significant rate
11 than the overall economy, as measured by the GDP deflator.

12 **Illustration 1**

13 **National Average Utility Infrastructure Cost Indices**



Sources: The Handy-Whitman® Bulletin, No. 165 and the U.S. Bureau of Economic Analysis Simple average of all regional construction and equipment cost indexes for the specified components. "Rising Utility Construction Costs: Sources and Impacts" Prepared by The Brattle Group for The Edison Foundation, September 2007

1 Q. Is there specific evidence that Avista is
2 experiencing cost escalations similar to that indicated in
3 the study?

4 A. Yes. As we explained in the past general rate
5 cases, Avista tracks the cost of materials and equipment
6 that Avista routinely uses in order to support various
7 infrastructure construction efforts that are part of the
8 Company's annual capital requirements.

9 In the recent analysis performed by the Company of all
10 cost of materials that are accounted for through the
11 Company's inventory system that pertain to the electric
12 transmission, electric distribution and natural gas
13 distribution functions, there continues to be an increase
14 in the average cost per unit of all materials, as shown in
15 Illustration 2 below.

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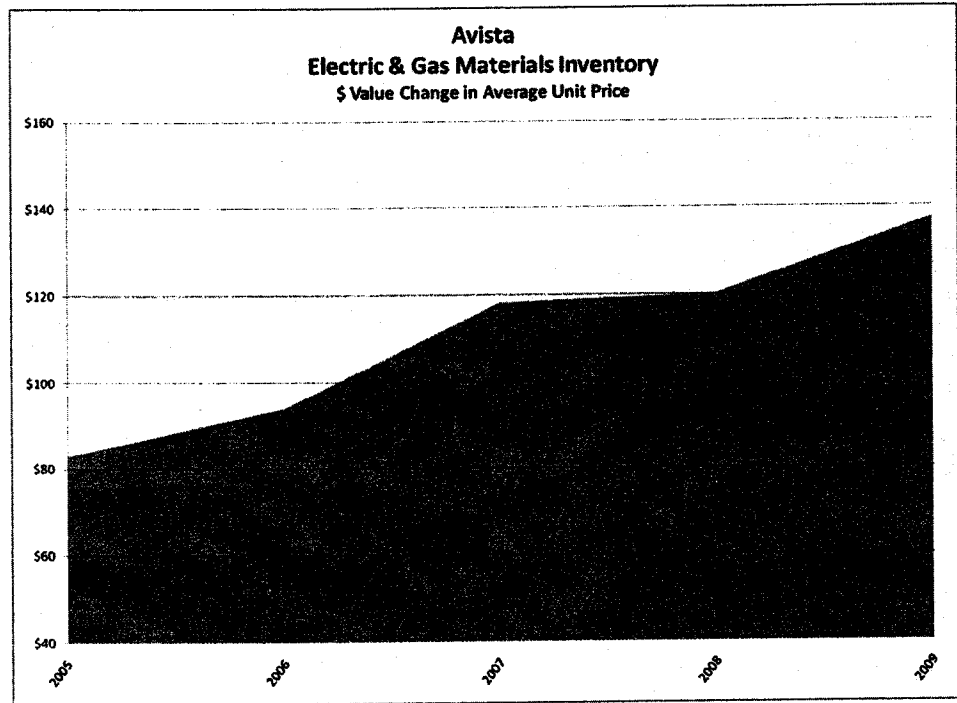
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1 **Illustration 2**



2
3 In 2005, the average cost per unit was \$82.95, in 2006
4 it was \$94.11, 2007 was \$118.16, 2008 was \$120.10 and for
5 2009 the cost was \$137.51 per unit. The average annual
6 increase over this four-year period is over 13%, which is
7 well above the general inflation that our overall economy
8 has experienced during the same timeframe. This
9 illustrates that costs continue a significant trend upward
10 as it relates to capital expenditures incurred that are
11 necessary to operate the system.

12 Another analysis that was performed on specific
13 materials is provided in Exhibit No. 9, Schedule 1. On
14 page 1, it can be seen that distribution transformers have
15 experienced price increases from 2005 to 2009 anywhere from

1 49% to 74%. While the study also showed that there was a
2 decrease in costs between 2008 and 2009, the one-year
3 decline in costs did not offset the large increases
4 experienced over the past five years. On page 2 of
5 Schedule 1 of the Exhibit, it can be seen that poles and
6 crossarms have also experienced substantial price increases
7 from 2005 to 2009 in the range of 50% to 123%, depending on
8 size. As noted in the Exhibit, some of the increase in
9 costs is due to changes in specifications from wood to
10 steel for certain poles and changes from wooded crossarms
11 to fiberglass crossarms, that Avista is now installing. On
12 page 3 of Schedule 1 of the Exhibit, a sampling of other
13 distribution materials shows that prices have steadily
14 risen from 2005 to 2009 for all but one category, conductor
15 600V 2/0 triplex; however the 2009 price of that conductor
16 is still 24% higher than the 2005 price.

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

19 A. Avista's annual capital requirements have
20 steadily increased from approximately \$130 million in 2005
21 to approximately \$210 million in 2010. Exhibit No. 9,
22 Schedule 2 reflects the trend that Avista has experienced
23 and what is planned for in the near future.

24 This chart not only shows the total magnitude of
25 capital expenditures, but also clearly shows that the

1 amount of capital projects is well in excess of revenue-
2 supported capital expenditures to connect new customers,
3 and beyond the level of revenues that is being collected
4 from customers related to existing plant. The difference
5 between the total capital requirements, less the new
6 revenue related capital, and allowed revenues represent a
7 significant discrepancy that is negatively impacting the
8 Company.

9

10

III. DESCRIPTION OF CAPITAL PROJECTS

11

**Q. For the 2010 capital projects pro formed in this
12 filing, please provide a description of the projects.**

13

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A. Exhibit No. 9, Schedule 3 details the capital
projects that will be transferred to plant in service in
2010 and included in this filing. A description of these
projects with system costs follows:

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Generation (\$33.4 million):

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The electric generation projects that will transfer to
plant in service are described in detail in Mr.
Storro's direct testimony. A listing of these
projects follows:

Thermal - Kettle Falls Capital Projects - \$1,817,000
Thermal - Colstrip Capital Additions- \$2,275,000
Thermal - Other Small Projects - \$78,000
Hydro - Nine Mile Upgrade - \$3,954,000
Hydro - Noxon Capital Project - \$7,551,000
Hydro - 2010 Noxon Unit #3 Upgrade - \$9,265,371
Hydro - Clark Fork/Spokane Implement PME Agreements -
\$4,053,000
Hydro - Other Small Projects - \$2,296,000
Other - Coyote Springs 2 (CS2) Capital Projects -
\$1,197,000

1 Other - Boulder Park - \$410,000
2 Other Small Projects - \$493,000
3
4

5 **Electric Transmission (\$18.9 million):**
6

7 The electric transmission projects that will transfer
8 to plant in service are described in detail in Mr.
9 Kinney's direct testimony. A listing of these
10 projects follows:
11

12 Lolo 230 kV Substation - \$1,450,000
13 Spokane-CDA 115 kV Line Relay Upgrades - \$1,250,000
14 Nez Perce 115 kV Substation Rebuild and Capacitor Bank
15 - \$3,575,000
16 SCADA Replacement - \$800,000
17 System-Replace/Install Capacitor Banks - \$750,000
18 Airway Heights-Silver Lake 115 kV Transmission Line -
19 \$975,000
20 Moscow 230-Pullman 115 Reconductor - \$1,300,000
21 Beacon Storage Yard Oil Containment - \$750,000
22 Colstrip Transmission Minor Rebuild - \$503,000
23 Tribal Permits - \$519,000
24 Reliability Improvements - Boulder-Rathdrum 115 kV
25 Transmission Line - \$1,500,000
26 Transmission Minor Rebuild - \$1,250,000
27 Power Circuit Breakers - \$485,000
28 Pine Creek-Replace 115 kV Circuit Switcher - \$570,000
29 Otis Orchards-115 kV Breaker and Line Relay
30 Replacements - \$650,000
31 Replacement Programs - \$2,044,000
32 Other small transmission projects - \$517,000
33
34

35 **Electric Distribution (\$40.3 million):**
36

37 The electric distribution projects that will transfer
38 to plant in service are described in detail in Mr.
39 Kinney's direct testimony. A listing of these
40 projects follows:
41

42 Appleway Substation - \$1,980,000
43 Deary Substation - \$1,405,000
44 Power Transformer Distribution - \$4,740,000
45 System-Dist Reliability-Improve Feeders - \$700,000
46 Distribution-CdA East & North - \$905,000
47 Rathdrum Transformer and 233 Feeder Addition -
48 \$900,000
49 Pine Creek-Replace 115 kV Circuit Switcher & Cap Bank
50 - \$300,000

1 Potlatch Transformer Replacement - \$250,000
2 Electric Distribution Minor Blanket - \$7,000,000
3 Wood Pole Replacement Program & Capital Distribution
4 Feeder Repair - \$6,884,000
5 Electric Underground Replacement - \$4,000,000
6 T&D Line Relocation - \$2,348,000
7 Failed Electric Plant - \$2,000,000
8 Other small distribution projects - \$640,000
9

10 The following electric distribution projects included
11 on Exhibit No. 9, Schedule 3, are specific to the
12 Washington jurisdiction and are not included in the
13 Idaho electric revenue requirement in this case.
14

15 Othello & Chewelah Transformer Replacements - \$950,000
16 Northeast Substation - \$900,000
17 Distribution - Spokane North and West - \$1,890,000
18 System-Dist Reliability-Improve Feeders - \$1,150,000
19 Spokane Electric Network Capacity - \$1,356,000
20

21
22 **General (\$11.4 million):**

23 Security Initiative - \$435,000
24 Various security measures including cameras and access
25 controls for the office and branch facilities.
26

27 Structures and Improvements - \$4,151,000
28 This is a group of capital maintenance projects that
29 Facilities Management coordinates at the Spokane
30 Central Operating Facilities and Avista branch
31 facilities - offices and service centers. For 2010,
32 planned projects include: roof replacements, land
33 acquisition for facility expansion, HVAC system
34 replacement at some branch offices, energy efficiency
35 projects, security projects, asphalt overlays and
36 replacement, several new vehicle building additions,
37 as well as some capital repair projects in existing
38 buildings.
39

40 Stores Equipment - \$600,000
41 Equipment utilized in warehouses and/or investment
42 recovery operations throughout the service territory.
43 This includes equipment such as forklifts, man lifts,
44 shelving, cutting/binding machines, etc.
45

46 Tools, Lab & Shop Equipment - \$1,700,000
47 Expenditures in this category include all large tools
48 and instruments used throughout the company for gas
49 and/or electric construction and maintenance work,

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distribution, transmission, or generation operations, telecommunications, and some fleet equipment (hoists, winch, etc) not permanently attached to the vehicle.

HVAC Renovation Project - \$3,499,000

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 2010 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 2009 portion of this capital project that was completed in late-2009.

WSDOT Highway Preservation/Maintenance of Right of Ways - \$500,000

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.

Other Small Projects - \$525,000

These projects include the completion of the Central Office Facility North Crescent Realignment project, office furniture additions and replacements, communication and security initiatives, radio equipment, telephone systems, office and other general facility upgrades.

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Transportation (\$10.0 million):

Transportation Equipment - \$9,971,000
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 gas operations. Some of the vehicles being purchased in 2010 will be equipped with diesel engines rather than gasoline engines. This is intended to increase life expectancy and generate fuel savings. The Company has pro formed annual fuel cost offsets of approximately \$129,000 (system) in reduced O&M costs.

Technology (\$11.5 million):

Information Technology Refresh Blanket - \$5,000,000
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 - \$1,100,000
A program to deliver technology associated with expansion of existing solutions.

AFM Product Development Program - \$1,000,000
Deliver enhancements to the electric and natural gas Facility Management technology system.

Nucleus Product Development Program - \$540,000
Deliver enhancements to the Nucleus energy resource management technology system.

Web Product Development Program - \$890,000
A program to deliver enhancements to the Customer based Web technology system.

Mobile Dispatch 2 - \$1,000,000
Implement Mobile Dispatch application for electric service and meter shop processes.

IFRS Compliance - \$1,000,000
Implementation of software required to meet International Financial Reporting Standards requirements. The project will likely include

1 upgrading the Oracle Financial Systems and
2 implementing a new Fixed Asset system. Schedule for
3 compliance is not yet finalized but the project is
4 expected to be completed over two years.
5

6 **AFM.net Upgrade - \$1,993,000**

7 The AFM system has reached a point where continued or
8 new application development and maintenance work
9 without refreshing the application language will cause
10 increased risk in system maintainability, reliability,
11 and application availability. The business relies on
12 this software for an increasing number of functions
13 and integrations that support customer and operating
14 transactions. With this technology refresh, the
15 productive life of the AFM system will be extended by
16 five to eight years.
17

18 **Other Small Technology Projects and Technology Minor**
19 **Blankets - \$2,910,000**

20 These projects include various small technology
21 projects including, technology to provide for field
22 office use of Learning Management System, installing a
23 fiber network that will replace an obsolete microwave
24 system, an electronic records management system,
25 upgrade of Oracle Database software and upgrade of
26 WorkPlace (CSS, WMS & EGMA).
27

28
29 **Jackson Prairie Storage (\$0.4 million):**

30 **Jackson Prairie Storage Project - \$429,000**

31 These projects include various capital improvements
32 that Avista and its partners will complete at Jackson
33 Prairie facility in 2010.
34

35
36 **Natural Gas Distribution (\$14.5 million):**

37 **Replace Deteriorated Pipe - \$1,050,000**

38 This annual project will replace sections of existing
39 gas piping that are suspect for failure or have
40 deteriorated within the gas system. This project will
41 address the replacement of sections of gas main that
42 no longer operate reliably and/or safely. Sections of
43 the gas system require replacement due to many factors
44 including material failures, environmental impact,
45 increase leak frequency, or coating problems. This
46 project will identify and replace sections of main to
47 improve public safety and system reliability.
48

