

BEFORE THE

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IDAHO PUBLIC UTILITIES COMMISSION

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-08-1
AVU-G-08-1**

**DIRECT TESTIMONY OF RANDY LOBB
IN SUPPORT OF STIPULATION**

IDAHO PUBLIC UTILITIES COMMISSION

AUGUST 22, 2008

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

3 A. My name is Randy Lobb and my business address is
4 472 West Washington Street, Boise, Idaho.

5 Q. By whom are you employed?

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

8 Q. What is your educational and professional
9 background?

10 A. I received a Bachelor of Science Degree in
11 Agricultural Engineering from the University of Idaho in
12 1980 and worked for the Idaho Department of Water Resources
13 from June of 1980 to November of 1987. I received my Idaho
14 license as a registered professional Civil Engineer in 1985
15 and began work at the Idaho Public Utilities Commission in
16 December of 1987. My duties at the Commission currently
17 include case management and oversight of all technical
18 Staff assigned to Commission filings. I have conducted
19 analysis of utility rate applications, rate design, tariff
20 analysis and customer petitions. I have testified in
21 numerous proceedings before the Commission including cases
22 dealing with rate structure, cost of service, power supply,
23 line extensions, regulatory policy and facility
24 acquisitions.

25 Q. What is the purpose of your testimony in this

1 case?

2 A. The purpose of my testimony is to describe the
3 principal components of the filed Stipulation (the Proposed
4 Settlement) and to explain the rationale for Staff's
5 support.

6 Q. Please summarize your testimony.

7 A. Staff believes that the comprehensive Proposed
8 Settlement agreed to by all parties is in the public
9 interest, is just and reasonable and should be approved by
10 the Commission.

11 Staff's support is based on its review of the
12 Avista gas and electric rate case filing, a comprehensive
13 audit of Company test year results of operations and
14 consideration of the rate case issues it intended to
15 present if this case were fully litigated.

16 The Company originally proposed a revenue
17 increase of \$32.33 million for electric service and \$4.7
18 million for natural gas service for an overall base rate
19 increase of 16.7% and 5.8% respectively. The Company
20 proposed a 10.80% return on equity. The Proposed
21 Settlement specifies an annual revenue requirement increase
22 of \$23.16 million on the electric side and \$3.88 million on
23 the gas side for an overall increase of 11.98% and 4.7%,
24 respectively. The parties agreed to a return on equity of
25 10.20%

1 The primary focus of Staff in its review of the
2 Company's filing was to evaluate the 2007 historic results
3 of operations for gas and electric service, assess the
4 adjustments made by the Company to those test year costs
5 and develop a reasonable revenue requirement. Other areas
6 investigated included class cost of service, rate design,
7 prudence of DSM expenditures and affordability.

8 While Staff's comprehensive audit and review of
9 the Company's filing identified a variety of adjustments to
10 the requested increase, the overwhelming cost drivers were
11 found to be critical facility investment and the rising
12 market price of purchased electricity and natural gas.

13 Staff's revenue requirement investigation
14 included a review of the Company's capital investment in
15 transmission, generation and metering, expense increases in
16 operation and maintenance, fuel and salaries. Staff also
17 evaluated test year expenditures to determine what costs
18 were known and measureable and used and useful in providing
19 service.

20 The cost of service study used by the Company in
21 this case was the same study used in the 2004 rate case.
22 While useful in assigning general revenue responsibility
23 for the customer classes, the study utilized stale load
24 data and was not accurate enough to make meaningful changes
25 in class revenue contribution or justify significant

1 changes in rate design. Based on its revenue requirement
2 analysis and cost of service and rate design evaluation,
3 Staff concluded that relatively few facts in this case were
4 in dispute. Staff believed that rather than face the
5 uncertainty of processing the case through a contested
6 technical hearing, customers could be best served by
7 bringing the parties together, candidly discussing its case
8 and negotiating a favorable settlement of issues.

9 Recognizing also the very real impact that higher
10 gas and electric costs will have on the low income
11 customers of Avista, the Proposed Settlement includes a
12 commitment to investigate alternatives to help mitigate
13 those impacts.

14 **The Settlement**

15 Q. What are the key components of the Proposed
16 Settlement?

17 A. The Proposed Settlement is attached as Staff
18 Exhibit No. 101. The key components of the Proposed
19 Settlement include an increase in the annual electric
20 revenue requirement of \$23.16 million or 11.98% and an
21 increase in the annual natural gas revenue requirement of
22 \$3.88 million or 4.74%. The revenue requirement was
23 established using a return on equity of 10.20%, a debt cost
24 of 6.84% and a capital structure of 48%/52% to produce an
25 overall return of 8.45%.

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The negotiated adjustments to the Company's original request removed over \$9 million from the proposed electric increase through deferral of pending capital and expense additions, removal of proformed test year costs as not known and measurable or not used and useful, and elimination or reduction of inappropriate or unjustified costs. Nearly all of the adjustments made in the natural gas revenue requirement resulted from allocated adjustments made in electric revenue requirement.

The Proposed Settlement is based upon a 2007 historic test year adjusted for known and measurable expense changes and major capital additions through 2008. It also specifies the use of 2009 power supply costs in the Power Cost Adjustment (PCA) mechanism and treatment of power supply costs associated with growing load (retail load and revenue credit).

Other issues addressed in the Proposed Settlement include verification of prudent DSM expenditures, a uniform increase in all customer class revenue except Potlatch Schedule 25P, and an increase in the residential customer charge for both electric and natural gas service. No other rate design changes were included.

Finally, the parties agreed to a series of commitments for customers including increased low income DSM funding, educational outreach for low income customers

1 and the need to address energy affordability through
2 generic workshops.

3 **Revenue Requirement**

4 Q. How did Staff identify adjustments to the
5 Company's case and what were the primary considerations in
6 reaching agreement on the stipulated revenue requirement?

7 A. Staff identified issues in this case by reviewing
8 the Company's rate case filing and conducting a
9 comprehensive audit of Company test year results of
10 operations. Staff then identified adjustments to the
11 Company proposed revenue requirement. The procedure used
12 by Staff in this case was the same process it uses in
13 preparing for a contested proceeding.

14 Staff then evaluated the justification for each
15 of the proposed revenue requirement adjustments to
16 determine at what level they could be successfully
17 supported at hearing. Staff established an overall revenue
18 requirement target that it believed could be achieved with
19 reasonable and reliable certainty and then negotiated
20 identified adjustments that had debatable and less
21 compelling justification to arrive at an overall revenue
22 requirement compromise.

23 Staff's ultimate goal was to balance the needs of
24 the Company for adequate revenue while securing the lowest
25 reasonable rates for customers.

1 Q. What type of adjustments did Staff identify and
2 how were they evaluated for settlement?

3 A. The single largest adjustments identified by
4 Staff in this case were those determined to be not "known
5 and measurable" or not "used and useful." For example,
6 Spokane River Relicensing costs, confidentially negotiated
7 agreements and expense increases/capital additions beyond
8 2008 were all adjustments associated with timing. Either
9 the projects were incomplete or future cost increases were
10 estimated or projected.

11 Staff believed it possible that some of the
12 larger timing adjustments could potentially be eliminated
13 or cured by the Company as projects and contract terms were
14 finalized by the time the case was processed through
15 hearing.

16 Q. Why was the Staff unable to identify more
17 definitive adjustments in the Company's proposed revenue
18 requirement?

19 A. The primary reason is that the Company simply
20 filed a relatively clean case and mitigated the effect of
21 many big ticket increases on which Staff has traditionally
22 focused its investigation. For example, the Company
23 proposed to include capital additions through the end of
24 2008 and utilize a year-end 2008 rate base rather than a
25 2008 average. The Company then offset most of the

1 resulting \$29 million increase by subtracting from rate
2 base an entire year of depreciation expense and adjusting
3 for deferred taxes. The net effect of the proposal was an
4 increase in rate base of only \$716,000 and a revenue
5 requirement increase of less than 1%.

6 The Company also proposed to calculate power
7 supply costs based on projected 2009 loads. It then
8 reduced the base rate revenue requirement by implementing a
9 Production Property Adjustment to reflect the fact that
10 2007 loads were used to recover costs. In addition, the
11 Company applied a hydro mitigation adjustment to purposely
12 reduce estimated power supply costs recovered through base
13 rates. Actual costs will be tracked through the PCA but
14 only at 90% of what would have been collected through base
15 rates.

16 For natural gas service \$3 million of the \$3.8
17 million increase agreed to in the Proposed Settlement is
18 associated with acquisition of Jackson Prairie natural gas
19 storage and installation of Automated Meters (AMR).
20 Additional storage will provide benefits to gas customers
21 through the annual Purchase Gas Adjustment (PGA) and AMR
22 provides significant savings in meter reading/customer
23 service expenses.

24 Finally, much has been made of executive
25 compensation. Newspaper reports cite total compensation

1 for the top five Avista executives of approximately \$3.6
2 million per year. The Proposed Settlement is based on
3 compensation of \$1.45 million per year or only 40% of total
4 compensation. While still seemingly high, if all the
5 compensation included in rates for the top 12 Avista
6 executives were eliminated, the effect would be a rate
7 reduction of less than 0.5%.

8 **Return On Equity**

9 Q. What is the return on equity specified in the
10 Proposed Settlement and how was it determined?

11 A. The Proposed Settlement specifies a return on
12 equity of 10.2%. This return is certainly within the range
13 that Staff would have recommended had the issue gone to
14 hearing. A 10.2% return was approved in Avista's recent
15 Washington settlement and is reasonable given the improved
16 financial performance of the Company and improved credit
17 rating upgrades by S&P and Moody's. It also recognizes the
18 ongoing capital requirements of the Company and the need
19 for investment grade ratings ("BBB-" or higher by Standard &
20 Poor's or "Baa-" or higher by Moody's).

21 **Net Power Supply Cost**

22 Q. Please explain how net power supply costs were
23 established at stipulated levels.

24 A. Staff reviewed all of the inputs and assumptions
25 used by the Company in the AURORA model to determine net

1 normalized power supply costs. Because the results
2 obtained using AURORA are particularly sensitive to
3 assumptions about natural gas prices, and because gas
4 prices have been extremely volatile since the time the
5 Company performed its analysis and filed its case, Staff
6 carefully examined the effect of different gas prices by
7 performing numerous simulations using gas price forecasts
8 from many sources and forward prices for 2009. In
9 addition, because pro forma power supply costs were based
10 on forecasted 2009 loads, Staff performed numerous
11 simulations to examine the effect of different load
12 assumptions. Staff concluded that the inputs and
13 assumptions used by Avista, including those related to fuel
14 prices and loads, were reasonable.

15 Q. Could gas prices and net power supply costs have
16 been higher than those agreed to in the Proposed Settlement
17 if argued at hearing?

18 A. Possibly. While natural gas prices have
19 moderated recently, they are still higher than those used
20 by the Company in calculating net power supply costs.
21 Incorporating higher gas costs in the power supply analysis
22 at a later date could have increased net power supply costs
23 recovered in base rates.

24 Q. Why has Staff agreed to the use of 2009 loads in
25 the calculation of base power supply costs?

