

DAVID J. MEYER  
VICE PRESIDENT, GENERAL COUNSEL, 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

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IDAHO PUBLIC  
UTILITIES COMMISSION

**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

IN THE MATTER OF THE APPLICATION )	CASE NO. AVU-E-08-01
OF AVISTA CORPORATION FOR THE )	CASE NO. AVU-G-08-01
AUTHORITY TO INCREASE ITS RATES )	
AND CHARGES FOR ELECTRIC AND )	
NATURAL GAS SERVICE TO ELECTRIC )	DIRECT TESTIMONY
AND NATURAL GAS CUSTOMERS IN THE )	OF
STATE OF IDAHO )	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 Marketing/Operations Departments,  
15 as well. In 1999, I accepted the Senior Business Analyst  
16 position that focuses on economic analysis of various  
17 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 activities ranging from financial analysis of numerous  
24 projects with various departments such as Engineering,  
25 Operations, Marketing/Sales and Finance. Also, a portion

1 of my job tasks involve advisory and informal training of  
2 employees pertaining to regulatory finance and ratemaking  
3 concepts.

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

5 A. My testimony and exhibits in this proceeding will  
6 cover the Company's proposed regulatory treatment of  
7 capital investments in utility plant through 2008.

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

9 A. Yes. I am sponsoring Exhibit No. 11, Schedule 1  
10 ("Rising Utility Construction Costs: Sources and Impacts"  
11 study from The Brattle Group), Schedule 2 (Capital  
12 Expenditures), and Schedule 3 (2008 Capital Additions  
13 Detail), which were prepared under my direction.

14

15 **II. CAPITAL INVESTMENT RECOVERY**

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

19 A. In this filing, we are proposing to include in  
20 retail rates the costs associated with utility plant that  
21 is in-service, and will be used to provide energy service  
22 to our customers during the 2009 pro forma rate year. This  
23 is consistent with prior ratemaking practice in the State  
24 of Idaho.

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

12           In the IPUC's Order No. 29602, in Case Nos. AVU-E-04-1  
13 and AVU-G-04-1, dated October 8, 2004, the Commission  
14 stated, at page 10, that:

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

1           If utility plant investment that is being used to  
2 serve customers is not reflected in retail rates then the  
3 retail rates will not be "just, reasonable, and  
4 sufficient," i.e., it would not be just or reasonable for  
5 customers to receive the benefit provided by the utility  
6 investment without paying for it, and the retail rates  
7 would not provide revenues "sufficient" to provide recovery  
8 of the costs associated with providing service to  
9 customers.

10           **Q. Is the Company's application of these ratemaking**  
11 **principles in this filing consistent with prior general**  
12 **rate cases?**

13           A. Yes. In prior cases, the objective has been the  
14 same -- to include in retail rates the investment, or rate  
15 base, that is providing service to customers, and ensure  
16 that there is a proper matching of revenues and expenses  
17 during the period that rates are in effect.

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

20           A. Historically, the annual dollars spent by the  
21 Company on new utility plant has generally been relatively  
22 close to the level of depreciation expense, with the  
23 exception of years where the Company has invested in major

1 new utility projects.<sup>1</sup> I will use an example to  
2 illustrate, in general terms, how new investment in utility  
3 plant changes rate base over time. Let's assume that the  
4 Company's rate base (adjusted net plant in service used to  
5 serve customers) at the beginning of Year 1 is \$1.5  
6 billion. Also assume that depreciation expense in Year 1  
7 is \$80 million, and the Company's new investment in utility  
8 plant in Year 1 is also \$80 million. During Year 1, rate  
9 base increased by \$80 million (new investment), and  
10 decreased by \$80 million (depreciation), and ended up at  
11 the same level of \$1.5 billion at the end of the year. In  
12 this simplified example, the Company's rate base is \$1.5  
13 billion, both at the beginning of Year 1, and at the end of  
14 Year 1. For ratemaking purposes, the \$1.5 billion of rate  
15 base is representative of the level of plant investment  
16 used to serve customers, both at the beginning of the year  
17 and at the end of the year. Over time, if depreciation  
18 expense continues to be approximately equal to new plant  
19 investment, rate base would continue at a relatively  
20 constant \$1.5 billion. Under these circumstances, the use  
21 of the \$1.5 billion rate base amount from a prior year,  
22 i.e., a historical test year, would be adequate for setting  
23 rates for the upcoming year (pro forma rate year), because

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<sup>1</sup> Recognizing that a portion of the costs associated with capital additions are offset by additional revenues.

1 there is little change in the net plant investment used to  
2 serve customers.

3 In a similar manner, in prior general rate cases we  
4 have used a rate base amount from a historical test year as  
5 the starting point for the pro forma rate year. If there  
6 were no major plant additions between the historical test  
7 year and the upcoming pro forma rate year, the historical  
8 test year rate base amount would be used for the pro forma  
9 rate year as being representative of the net plant used to  
10 serve customers. If there were known major plant additions  
11 that would be in service for the pro forma rate year, such  
12 as the recent addition of Coyote Springs II for Avista, the  
13 major transmission upgrades, and the hydroelectric  
14 upgrades, then rate base for the pro forma rate year is  
15 adjusted for these major investments, so that rate base for  
16 the pro forma rate year is representative of the level of  
17 investment used to serve customers.

18 **Q. Is Avista's new investment in utility plant**  
19 **exceeding its annual depreciation expense, causing an**  
20 **increase in rate base?**

21 A. Yes. Avista's investment in plant in 2007 and  
22 2008, is well above the annual depreciation expense, and  
23 will result in an increase in net plant in service (rate  
24 base) that will be used to serve customers in the 2009 pro  
25 forma rate year. Much of this new investment in plant for

1 2007 and 2008 is spread among many different utility plant  
2 categories, as opposed to a few major plant additions.  
3 Therefore, the Company's pro forma adjustment for new  
4 investment in plant in this filing involves a more detailed  
5 analysis of the net change in rate base from the historical  
6 test period to the pro forma rate year. The end result,  
7 however, is the same in this case as in prior cases - to  
8 reflect in retail rates the level of net plant investment  
9 that is used to serve customers during the pro forma rate  
10 year, and to have a proper matching of revenues and  
11 expenses.

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

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 calendar year 2007. Adjustments were made to reflect  
17 new additions and accumulated depreciation through December  
18 2008, such that the proposed rate base reflects the net  
19 plant in service that will be used to serve customers  
20 during the 2009 pro forma rate year. Later in my testimony  
21 I will provide the details of the adjustments to rate base.

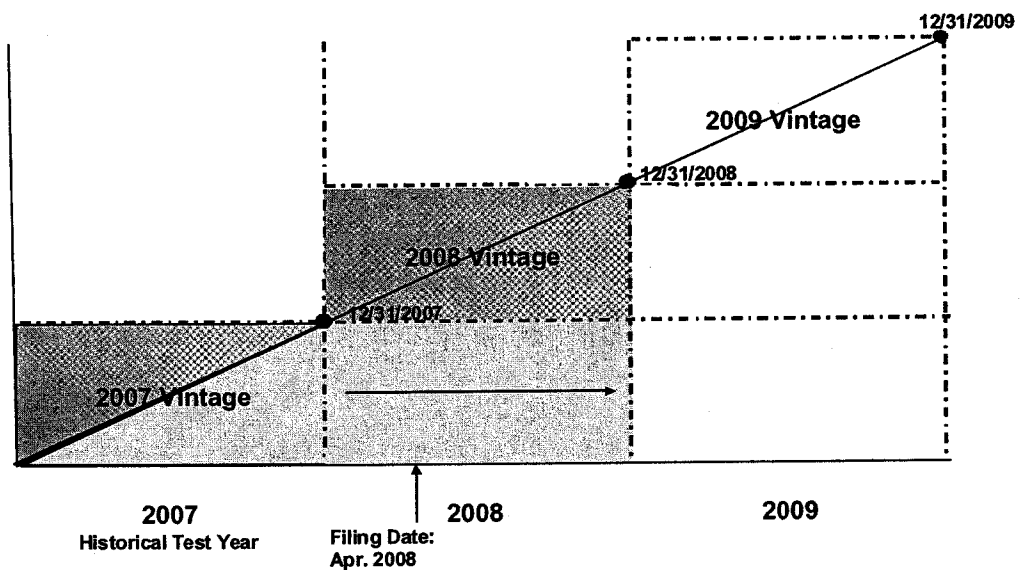
22 Although there is a strong case to be made that the  
23 new capital investment in 2009 will be used to serve  
24 customers during the 2009 rate year, and should be

1 reflected in this case, the Company has only included new  
2 investment through December 2008.

3 The capital additions through 2008 will be in-service  
4 at the approximate time new rates become effective from  
5 this rate filing, and customers will be receiving benefits  
6 from this investment. The following chart illustrates the  
7 2007 historical test period and the April 2008 filing of  
8 this case. The chart also illustrates that the capital  
9 additions for 2007 and 2008 will be completed and in  
10 service prior to January 1, 2009. During 2009 customers  
11 will receive the benefit from the full investment in 2007  
12 and 2008, and it is appropriate for this investment to be  
13 reflected in the retail rates for 2009.

14  
15 **Illustration 1**

16 **Capital Additions 2007 – 2009**  
17 **Avista Utilities**



1           As illustrated by the chart, if the proposed rates in  
2 this case go into effect near the end of 2008, the 2007  
3 plant additions will be entering their third year of  
4 service during calendar year 2009, and the 2008 capital  
5 additions will be in their second year of service in 2009.  
6 Clearly the 2007 and 2008 investment will be providing  
7 service to customers, and would reflect the true cost of  
8 funding assets that are necessary, and used and useful, to  
9 provide service to customers during the year that new rates  
10 will be in effect. It would result in a mismatch of  
11 revenues and expense during 2009 if the costs associated  
12 with these investments are not reflected in new retail  
13 rates.

14           **Q. You stated earlier that new utility investment in**  
15 **2007 and 2008 will be substantially higher than the annual**  
16 **depreciation expense. What is driving the significant**  
17 **investment in new utility plant?**

18           A. The Company is currently being required to add  
19 significant new transmission and distribution facilities,  
20 including strengthening the "back bone" of our system, due  
21 in part to customer growth in our service area, reliability  
22 requirements, and capacity upgrades. Other issues driving  
23 the need for capital investment include an aging  
24 infrastructure, physical degradation, and municipal  
25 compliance issues (i.e., street/highway relocations), etc.

1 While the overall economy is slowing on a national basis,  
2 Kootenai County is still growing. In 2007, employment  
3 growth in Kootenai County ranked in the top 5% of all  
4 metropolitan areas.

5 In addition, the cost of raw materials, including  
6 concrete, steel, copper, aluminum and other materials, have  
7 sky-rocketed in recent years, causing the cost of these new  
8 facilities to be significantly higher than in the past.  
9 Because the cost of adding new facilities is significantly  
10 higher than the existing facilities, the investment in new  
11 facilities will be significantly higher than the annual  
12 depreciation expense on the existing facilities.

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

15 A. In September 2007, The Edison Foundation  
16 commissioned a study from The Brattle Group titled, "Rising  
17 Utility Construction Costs: Sources and Impacts," which  
18 identified cost trends specifically related to the utility  
19 industry pertaining to critical materials and equipment, as  
20 well as labor support services used for building capital  
21 infrastructure. This study is attached as Exhibit No. 11,  
22 Schedule 1. The study identifies the reasons for drastic  
23 cost increases in critical raw materials, such as global  
24 competition and an aging domestic utility infrastructure as

