

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

DOCKET NO. UE-991255
APPLICATION TO SELL THE CENTRALIA POWER PLANT

REBUTTAL TESTIMONY OF THOMAS D. DUKICH

REPRESENTING AVISTA CORPORATION

1 Q. Please state your name, business address and present position with the
2 Company?

3 A. My name is Thomas D. Dukich. My business address is East 1411 Mission
4 Avenue, Spokane, Washington. I am the Director of Rates and Tariff Administration.

5 Q. Have you previously filed testimony in this proceeding?

6 A. Yes.

7 Q. What is the scope of your rebuttal testimony?

8 A. In my rebuttal testimony I respond to the testimony of staff and intervenor
9 witnesses related primarily to the disposition of the gain on the sale of Centralia. Where
10 possible I have responded to the particular issue raised, rather than responding separately to the
11 testimony of each witness.

12 Q. Are you sponsoring any exhibits with your rebuttal testimony?

13 A. Yes, I am sponsoring Exhibit Nos. 319 through 321, as marked for
14 identification.

15 Q: Do you have any opening comments before turning to the specific issues raised
16 by other witnesses in the case?

17 A: Yes. First of all I would like to clarify and summarize my testimony since there
18 may be some confusion regarding the rationale for Avista's proposal regarding the disposition
19 of the gain. Our proposal is premised upon balancing the interests of customers and
20 shareholders. In my direct testimony I outlined what I believe to be the current status of this
21 balance as the Commission faces the decision regarding the gain on the sale: Customers have
22 been well served by Avista as evidenced by the fact that rates have varied between the lowest

1 and the fifth lowest in the United States over the last 20 years. Several independent studies
2 have rated Avista's customer service and business operations as outstanding. How have
3 shareholders fared during this time? They have clearly not been shielded from significant
4 losses. Before tax write-offs since 1985 have totaled over \$96 million. Regulated rates of
5 return since 1973, which exclude the impact of these write-offs, have not unduly enriched
6 shareholders.

7 My testimony speaks to the balance of interests between customers and shareholders,
8 and requests that the Commission consider this balance in its decision. It is our position that
9 allowing Avista to retain all or a portion of the gain balances the interests involved without
10 diminishing future customer service or rates.¹

11 In evaluating the Company's position, I believe it would be helpful to focus on an
12 important threshold question: Should the gain from the sales of Avista's utility assets always
13 go to customers? For the following reasons, we believe the answer to this question is no.

14 **1. Commission Rules and Policies Allow a Gain to Shareholders:** We are not aware
15 of any stated Commission policies or rules that require gains from sales of utility assets

17 ¹ One approach to allocating gain on the sale of an asset was outlined in Democratic Central Committee v.
Washington Metro. Area Transit Comm., 485 F.2d 786 (D.C. Cir. 1973). On pages 805-806 the court framed the
18 task as follows:

19 "Investors, we have concluded, are not automatically entitled to gains in value of operating utility properties
20 simply as an incident of the ownership conferred by their investments. And it goes without saying that consumers
do not succeed to such gains simply because they are users of the service furnished by the utility. Neither capital
investment nor service consumption contributes in any special way to value-growth in utility assets. Rather, the
values with which we are concerned have grown simply because of a rising market.

21 Investors and consumers thus start off on an equal footing, and the disposition of the growth must depend on other
factors. We thus reach the dual critical inquiry; identification of the principles which must guide the allocation,
as between investors and consumer groups, of appreciation in value of utility assets while in operating status; and
application of those principles to transit's situation."

22 Over 25 years have passed since this decision. There have been significant changes in the electric utility industry
during this time and this case may not be entirely on point. Nevertheless, it can provide a useful framework for
debate and discussion and I have used it for this purpose.

1 to flow exclusively to customers. In fact, in the Commission’s order related to the sale
2 of Colstrip by Puget Sound Energy, states as follows:

3 “If the gain from the Colstrip sale clearly accrued benefits beyond the breakeven
4 point, then the Commission would need to determine whether or how to share those
5 benefits between ratepayers and shareholders.”

6 Therefore, the Commission’s rules and policies do not seem to preclude the assignment
7 of all, or a portion, of the gain on the sale of Centralia to shareholders.

- 8 **2. The Allowed Rate of Return does not Preclude a Gain to Shareholders:** Sales of
9 assets such as Centralia are subject to a specific decision of the Commission granting
10 approval of the sale. With regard to any gains on these sales, the Commission has stated
11 that there are instances where the Commission must determine “whether or how to share
12 those benefits between ratepayers and shareholders.” If the rate of return was either
13 implicitly or explicitly established under the assumption that all gains from all sales of
14 assets were to be assigned to customers, then there would be no need for the Commission
15 to pose such a question. It would already be answered. The rate of return established by
16 the Commission for the Company does not, in and of itself, preclude a decision by the
17 Commission to assign all, or a portion, of the gain on Centralia to shareholders. In the
18 past the Commission has issued decisions disallowing recovery of a portion of
19 investments made by the Company in generating facilities. In both instances, either a
20 disallowance of investment recovery or an assignment of a gain to shareholders, the
21 decision of the Commission has a direct financial impact on financial statements and
22 shareholders, irrespective of the rate of return authorized by the Commission for the

1 Company. Regulated rates of return do not reflect the impact of disallowances or book
2 gains.

3 **3. The Commission is a Surrogate for Competition:** One theory of regulation is that the
4 Commission serves as a substitute or surrogate for competition to ensure that pricing to
5 customers is fair, just and reasonable, and that service is safe and reliable.² The presumed
6 monopoly status of the utility and the corresponding regulation by the Commission,
7 however, does not result in customers owning the utility's assets. Commission regulation
8 is primarily economic in the sense that prices are regulated through an analysis of various
9 costs, including capital return. Legal and operational ownership, however, resides with,
10 and is the responsibility of, the utility. It is the Company's decision, in the first instance,
11 to determine whether to acquire or dispose of assets. Many of the Company's decisions,
12 however, are subject to the specific approval of the Commission, including the financial
13 impact on customers from those decisions. In the competitive world, both the gains and
14 losses from investment decisions rest with the business owners. Monopoly status, in and
15 of itself, does not preclude the assignment of both gains and losses to shareholders. As
16 the surrogate for competition, it is the Commission's decision as to how gains and losses
17 are shared between customers and shareholders.

18 **4. Symmetry:** On Page 16, Line 8 of his testimony, Mr. Elgin states that, "Indeed, if any
19

20 ² The Company is also subject to other sources of competition in the form of alternate fuel sources, neighboring
21 public utilities (Washington does not have exclusive service territories), and Bonneville Power Administration
22 (BPA). BPA serves as wholesale provider of preference power to public agencies within a statutorily defined
 region in the Northwest that includes all of Avista's service territories. Avista competes with BPA's public agency
 preference customers for retail load on the fringes of its service territory. In addition, certain customers, such as
 federal agencies, have direct rights to purchase from BPA. In 1990 Avista lost the housing load of Fairchild Air
 Force Base to BPA. All of this competition places pressure on Avista to keep its rates low to meet competition.

1 of the gain is kept by the utility, shareholders will be provided excessive returns through
2 accretion in the utility's book value." We agree with Mr. Elgin that the Centralia gain
3 assigned to shareholders will result in an increase in book value for the Company.
4 However, it is also true that the Company's book value has been significantly decreased
5 in the past for the investments that were disallowed for recovery by the Commission
6 related to WNP-3, Skagit, and Kettle Falls (Exhibit No. 309). If there is to be symmetry
7 (fairness), it is necessary for there to also be an increase in book value from time to time,
8 along with the decreases that have occurred from the investment disallowances.
9 Therefore, it would be appropriate for there to be an increase in book value associated
10 with the gain on Centralia. To my knowledge there are no Commission orders that state
11 in any way that the allowed return on rate base for the Company is a "No Gains" return.
12 That is, the allowed rate of return has not been characterized as a return that requires the
13 Company to absorb losses associated with the acquisition of assets, but precludes the
14 Company from receiving any gains on the disposition of assets. Again, as I stated in my
15 direct testimony, the purpose of the Company's testimony regarding the prior
16 disallowances of investment by the Commission is not to complain or to call into
17 question the fairness of those prior decisions. The Company is simply requesting that the
18 Commission carefully consider the balance of equities between customers and
19 shareholders in its decision regarding the disposition of the gain.

20 Q: On Page 15 of Mr. Elgin's testimony he discusses market based returns on net
21 book value as fair compensation to shareholders (Line 20). Do you have any comments on this
22 portion of his testimony?

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

A: Yes. It is important to note that Mr. Elgin has referred to a return on “net book value.” Furthermore, on Page 24, Line 19 Mr. Elgin states as follows:

“Shareholders are compensated for accepting this ongoing risk of prudently managing the resource while it is in rate base, and as long [as] Centralia continues to produce power, ratepayers will pay rates that reflect the ongoing reasonable costs of power produced by the plant. These costs include compensation to shareholders for the risks of ownership.” (underscores added)

“Net book value” and “rate base” include the value of any investments for which the Commission has granted recovery through retail rates. In general, an investment which has been disallowed for rate making purposes must be written off by the Company, and net book value and rate based is reduced. The Company receives neither a return on, nor a return of this investment. Therefore, the Company has the opportunity to earn the allowed return only on the investment that the Commission has approved for recovery in rates.

Q: In his discussion of investment disallowances at the bottom of Page 21, Mr. Elgin states that ratepayers paid for resources that never reached commercial operation. Do you have any comments on this testimony?

A: Yes. To my knowledge, the Skagit Project is the only resource investment made by the Company where no power was received, and for which some cost recovery was provided through retail rates. For Skagit, the Company received only partial recovery of its investment through an adjustment to retail rates. The cost of this project was split approximately 50% to customers and 50% to shareholders. The Company is receiving power from the Kettle Falls Project, and is also receiving power related to its investment in the WNP-3 Project. The Company wrote off its \$11.2 million investment in the Creston Project without receiving or

1 requesting a change in retail rates.

2 Although customers absorbed a portion of the costs of the Skagit Project, shareholders
3 also incurred a write-off and and reduction to book value. Customers, however, are also
4 receiving substantial benefits from favorable resource decisions made by the Company, such
5 as the low-cost power contracts with the Mid-Columbia PUDs explained on Page 7 of my direct
6 testimony.

7 The gain on the sale of Centralia represents economic value over and above the book
8 value of the asset and the amount rate based. Customers have not been charged a return on this
9 economic value (the gain), nor have they paid depreciation based on this economic value. Any
10 portion of the gain assigned to shareholders, therefore, would not take away from customers
11 any value that they have or are currently receiving.

12 Q: On Page 23 of his testimony, Mr. Elgin suggests that Avista's direct testimony
13 calls into question the fairness of prior decisions of the Commission. Do you have any
14 comments on this portion of Mr. Elgin's testimony?

15 A: Yes. It is very important that our testimony not be misinterpreted. Perhaps I
16 was not clear enough, so I would like to restate our position in this regard. The purpose of our
17 testimony is not to complain, contest, revisit, or call into question the fairness of the prior
18 decisions of the Commission. The purpose is to simply show that past Commission decisions
19 have in fact resulted in significant write-offs (losses) to shareholders, and that a balance of
20 interests for customers and shareholders points to occasional gains for shareholders along with
21 the losses.

22 Q: On Page 16 of his testimony, Mr. Elgin states that ". . . Centralia was

1 depreciated too quickly. Therefore, ratepayers paid excessive depreciation expense and
2 shareholders benefited since capital was returned too quickly." Do you have any comments on
3 these statements?

4 A: Yes. With regard to the question of a benefit to shareholders, retail rates are set
5 to provide a return of capital to the Company equal to the depreciation expense, and a return
6 on the remaining investment that has not yet been depreciated. The Company no longer earns
7 a return on the portion of its investment that has been depreciated. The revenue received
8 related to the depreciated portion must be reinvested by the Company in order for it to continue
9 to earn a return on its capital. If Centralia had been depreciated at a slower pace, it would have
10 had no earnings impact on the Company. The lower depreciation expense would have resulted
11 in lower revenues to the Company, and no net change in earnings, i.e., the revenue to the
12 Company is set to match the depreciation expense.

13 As to whether Centralia was depreciated too quickly, we may have been dealing with
14 a write-off in this case associated with shutting Centralia down due to air quality requirements
15 or some other reasons. If that were the case, it could be said that the plant was not depreciated
16 quickly enough, and that depreciation expense had been too low. In fact, just such a result
17 logically follows from Mr. Lazar's testimony (Page 3, Line 24) with regard to his 1997 position
18 on the value of Centralia.

19 Centralia has been in operation since 1972. There have been many opportunities since
20 that time to adjust the depreciation expense for Centralia. On Page 23, Line 5 of his testimony,
21 Mr. Elgin states that, "Prior decisions by this Commission evaluated all relevant evidence and
22 treated all parties fairly." Then on the same page, Line 8, he states that "It would be inequitable

1 and unfair to the parties in those prior rate proceedings to revisit those prior decisions." We
2 concur. The same can be said of the allowed level of depreciation for Centralia. There are
3 many factors that affect the useful life and value of a generating plant, including location,
4 access to fuel supply, operating history, environmental impacts, etc. The historical depreciation
5 expense, approved by the Commission, was based on the best information available and we can
6 only conclude that it was set at a level that was fair, just and reasonable.

7 Q: On Page 18 of his testimony, Mr. Elgin proposes that the Commission's
8 treatment of the gain on the sale of Centralia be uniformly applied to each of the three utilities.
9 Do you agree with this proposal?

10 A: No. Although the Commission is obviously not precluded from ordering similar
11 treatment of the gain for the three utilities, the Commission in the past has avoided a "one size
12 fits all" approach to regulation. For example, the investment recovery provided by the
13 Commission related to WNP-3 was different for Avista and Puget Sound Energy. Both
14 companies had invested in the same generating project, but received different cost recovery
15 treatment. In this case, it may be appropriate for differing treatment of the disposition of the
16 gain for each utility, based on the unique circumstances of each utility. I have outlined Avista's
17 unique circumstances in my direct testimony.

18 Q Beginning on Page 4, Line 8 of his testimony, Mr. Elgin recommends deferring
19 decisions regarding the disposition of the gain from the sale of Centralia to a general rate case?
20 Do you have any comments on this testimony?

21 A Yes. Decisions of the Commission regarding the exact disposition of the gain
22 represent additional conditions related to the sale of Centralia, over and above the decision

1 whether or not to allow the sale. It is reasonable and appropriate for the Company to have
2 knowledge of these regulatory conditions in making its final decision related to selling the
3 plant. Therefore, decisions related to the disposition of the gain on the sale of Centralia should
4 be made in this proceeding. Should the Commission determine that a portion of the gain
5 related to the sale of Centralia be assigned to customers, Mr. McKenzie's direct testimony
6 explains the Company's position regarding the treatment of the customer portion of the gain.

7 Q: On Page 4 of Mr. Martin's testimony, he discusses a prior decision of the
8 Commission related to gains on sales of property in a Puget Sound Energy case. Do you have
9 any comments on this testimony?

10 A: Yes. We believe it can be helpful to look at prior decisions of the Commission,
11 if the issues and circumstances in the case are such that a direct application can be made to the
12 current case. The case referred to by Mr. Martin, however, involved multiple sales of non-
13 depreciable real property by Puget Sound Power & Light during the period 1974 to 1989
14 (Docket U-89-2688-T). We do not believe that the issues and circumstances in that case
15 support a similar decision in this case, or in any way binds the Commission to a similar
16 decision, especially since that case involved a stipulation.

17 The Stipulation in Docket U-89-2688-T clearly states that the gains at issue in the case
18 were related solely to sales of non-depreciable real property. In Avista's current filing, the gain
19 is related to the sale of a major base-load generating resource. The Company's investments in
20 generating resources have been subjected to rigorous reviews that have resulted in substantial
21 write-offs for the Company. A decision related to the disposition of the gain on the sale of
22 Centralia is clearly in a different category than that of the relatively minor real property

1 transactions.

2 Q: Beginning on Page 4, Line 15 of his testimony, Mr. Martin discusses the
3 disposition of a gain on the sale of a combustion turbine generator by the Company. Do you
4 have any comments on this testimony?

5 A: Yes. In 1987 the Company sold its Othello combustion turbine generator and
6 realized an after-tax gain of \$143,000 applicable to the Washington jurisdiction. The turbine
7 was fueled by oil, and was relatively inefficient, and consequently, in the years leading up to
8 the sale, was called upon very little by the Company. In its order approving the sale in Docket
9 No. 87-1533-AT, the Commission ordered the Company to defer the gain in a deferred credit
10 account until final disposition of the gain was determined in the Company's next general rate
11 case.

12 In a stipulation filed with the Commission in 1990 (Docket No. UE-900093) the
13 Company and Commission Staff reached agreement to apply \$84,000 of the gain to offset
14 Company write-offs related to Othello turbine fuel and Shawnee transmission materials. The
15 remaining \$59,000 of the gain was included as a rate base reduction in the calculation of the
16 Company's revenue requirement in Docket No. UE-900093. The gain on the sale of Othello
17 involved a stipulation and was obviously relatively immaterial, and in our opinion should not
18 be considered precedent setting.

19 Q Do you agree with Mr. Lazar's recommendation, beginning at Page 3, Line 18
20 of his testimony, that approval of the sale of Centralia should be conditioned upon a covenant
21 by the Company to supply power in the future at the estimated cost of ownership and operation
22 of Centralia?

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

A No, this would not be an acceptable condition. The Company is not compensated in its allowed rate of return for guaranteeing that market prices for the next 20 years or more will be below certain levels. Furthermore, such a condition was not factored into Avista's decision to sell the plant.

Q: On Page 6, Line 1 of Mr. Wolverton's testimony, he states that "To allocate less than 100 percent of the gain to ratepayers would deprive ratepayers of the benefits of the asset they have paid for over time, and which they will otherwise receive if the sale is not completed." Do you have any comments on this statement?

A: Yes. On Page 13, Line 19 of his testimony Mr. Wolverton also states with regard to Centralia that:

"It is, in effect, a ratepayer asset. Because ratepayers have been responsible for paying all the costs associated with Centralia, ratepayers should receive all of the benefits from the sale."

Historically, customers have not paid all of the investment costs associated with generating projects, as evidenced by the write-offs experienced by the Company, e.g., WNP-3 and Kettle Falls. Customers no more own the generating assets than I own some of McDonalds because I purchased some of their Big Macs. Simple use of a product, even if the price is based on cost, does not result in ownership of the means of producing that product.

As I have previously stated in my testimony, monopoly status, and the existence of regulation as a surrogate for competition, does not transfer ownership of assets to customers, and does not preclude shareholders from receiving gains from the sale of assets.

Q: On Page 7 of Mr. Wolverton's testimony, he states that ". . . it is prudent to adopt

1 policies now that balance the interests of shareholders and ratepayers regarding potential
2 stranded costs or benefits." Do you agree?

3 A: No. Electric industry restructuring on a broad scale has not yet occurred in the
4 State of Washington, nor does it seem imminent. It would be premature to make decisions, or
5 adopt policies, related to electric restructuring now, before all the factors that would need to
6 be taken into consideration are known, including any possible legislation. It is also not
7 necessary or prudent to make specific stranded cost or benefit decisions now, in dealing with
8 the proposed sale of Centralia.

9 Q: Beginning on Page 17 of his testimony, Mr. Wolverton uses non-production cost
10 calculations on a per customer basis for various utilities to draw conclusions related to the
11 efficiency of Avista as a utility. Do you have any comments on this testimony?

12 A: Yes. While benchmarking creates some interesting comparisons between
13 companies, it is important to be mindful of factors that may mislead or confound the
14 comparison. For example, in a comparison of non-production costs, the difference in
15 population density from one company's service territory to another may cause materially
16 different costs per customer by various cost categories. Puget Sound Energy has approximately
17 65% more customers per distribution line mile than Avista Utilities, and over twice the number
18 of customers per transmission line mile, which could result in major differences in transmission
19 and distribution costs on a per customer basis. In fact, as shown in Exhibit No. 319, for Avista,
20 PSE, Idaho Power, and PacifiCorp, there is a substantial correlation between customers per
21 distribution line mile and non-production costs ($r = 0.73$). In this instance, non-production cost
22 can be said to reflect customer density per line mile rather than efficiency as claimed by Mr.

1 Wolverton. The age of the distribution system can also have an influence on costs.

2 In addition, the size of a utility has an influence on fixed costs per customer. Customer
3 service expenses, including call centers and computer systems, can serve a much larger
4 customer base with relatively minor incremental costs. Spreading these fixed costs over a
5 smaller customer base drives up the cost on a per customer basis. Pacificorp has almost five
6 times the number of customers as Avista, and Puget has almost three times the number of
7 customers as Avista.

8 Because of the obvious geographical, demographic, and size differences in the service
9 territories, we do not believe the data provided by Mr. Wolverton provides a proper
10 representation of the efficiency of Avista.

11 Avista has consistently ranked high in independent studies of economic efficiency and
12 business excellence. I have cited four such studies in Exhibit No. 320, which provide a more
13 comprehensive indication of comparative efficiencies. A 1999 study published by Fitch
14 Investors Services provides another indication of Avista's efficiency. The Fitch study includes
15 a comparison of the embedded costs of transmission service, the embedded costs of distribution
16 service, and embedded common and general costs among utilities. Avista ranked either first
17 or second lowest among other Western utilities for each cost category, as shown in Exhibit No.
18 321.

19 These studies provide comparisons based on what customers actually pay: cents per
20 kilowatt-hour. In our opinion, this is a much more comprehensive and valid measure than the
21 one selected by Mr. Wolverton.

22 Q: Do you have any further comments related to the testimony of staff and

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

intervenor witnesses in the proceeding?

A: Yes. Some of the staff and intervenor witnesses raised the same or similar issues. For the sake of brevity the Company has not attempted to respond to each statement of each witness on the common issues. To the extent that a witness has made a statement that the Company has not specifically responded to, our silence does not indicate agreement.

Q. Does this conclude your rebuttal testimony?

A. Yes.