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P R O C E E D I N G S

2

JUDGE MOSS: Good morning, everyone. We are here this morning on September the 6th to resume our evidentiary proceedings in Docket Number UE-010395, and a couple of preliminary matters. I have distributed to counsel and to the Bench this morning an updated exhibit list that captures the activity from yesterday, and I also have distributed a Bench request to the company and have had some informal discussion with the company. The Bench request calls for data through the end of August, cash flow statements. The company indicates that it can provide the requested information through the end of July by the requested date, which is September 10th, and that it will make efforts to provide the August data as soon thereafter as can be done.

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So with that, I think we can move on to having Mr. Hoover, I believe it is, to be our first witness.

MR. MEYER: Very good, I call to the stand Mr. Thomas Hoover.

(The following exhibits were identified in conjunction with the testimony of THOMAS J. HOOVER.)

Exhibit 350-T is Pre-filed rebuttal testimony. Exhibit 351 is Staff Cross-Exam Exhibit:

00406

1 Avista Response to Staff Data Request No. 182. Exhibit
2 352 is Staff Cross-Exam Exhibit: Avista Response to
3 Staff Data Request No. 99.

4

5 Whereupon,

6

THOMAS J. HOOVER,
7 having been first duly sworn, was called as a witness
8 herein and was examined and testified as follows:

9

10 DIRECT EXAMINATION

11 BY MR. MEYER:

12 Q. Mr. Hoover, for the record, please state your
13 name.

14 A. My name is Thomas J. Hoover.

15 Q. By whom are you employed?

16 A. Deloitte & Touche.

17 Q. Have you prepared and had pre-filed rebuttal
18 testimony in this case marked as Exhibit 350-T?

19 A. Yes, I have.

20 Q. If I were to ask you the questions that
21 appear in that pre-filed testimony, would your answers
22 be the same?

23 A. Yes, they would.

24 MR. MEYER: With that, I move the admission
25 of Exhibit 350-T.

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1 JUDGE MOSS: Hearing no objection, it will be
2 admitted as marked.

3 MR. MEYER: The witness is available for
4 cross.

5 JUDGE MOSS: And I believe we start with
6 Staff.

7

8 C R O S S - E X A M I N A T I O N

9 BY MR. TROTTER:

10 Q. Welcome, Mr. Hoover.

11 A. Thank you.

12 Q. Turn to page two of Exhibit 350-T, and on
13 line -- beginning on line ten, you indicate that you and
14 your employer, Deloitte & Touche, are independent with
15 respect to the company, correct?

16 A. That's correct.

17 Q. And that means in part that you conduct your
18 own independent audit of the company's books and
19 records, correct?

20 A. That's correct.

21 Q. Your role is not to concur with what Avista
22 does, but to reach your own independent conclusions
23 apart from Avista's conclusions, correct?

24 A. Our role is to reach an independent
25 conclusion, but that sometimes involves concurring with

00408

1 what the company does.

2 Q. Let me ask it another way. Your role is not
3 to simply look at what Avista has done itself and sign
4 off on that, but rather to investigate all available
5 evidence surrounding what Avista has done and determine
6 whether what they did was correct?

7 A. Maybe I can clarify. Our role is not to just
8 accept, take at face value what they have done, but to
9 perform an independent investigation, review, analysis.

10 Q. And so you are to investigate to assure that
11 the information that you are provided is complete?

12 A. That's correct.

13 Q. And am I also correct that you and your audit
14 team do not receive anything of value from Avista other
15 than your firm's fees?

16 A. That's correct.

17 Q. Mr. Hoover, I would ask you to assume that a
18 regulatory asset is recorded on the company's balance
19 sheet and your firm issues an affirmative opinion. Do
20 you have that assumption in mind?

21 A. Yes.

22 Q. Now assume that recovery of that cost was not
23 probable under FAS 71 based on all available evidence.
24 Do you have that assumption in mind?

25 A. Okay.

00409

1 Q. What are the consequences for Deloitte &
2 Touche under those assumptions?

3 A. If I hear you correct that the company has a
4 regulatory asset recorded on their books and we believe
5 then upon further evidence that the asset should not be
6 recorded?

7 Q. Well, let's run it by you again.

8 A. I apologize, perhaps I misunderstood.

9 Q. The regulatory asset is recorded and you
10 issue an affirmative opinion. It turns out that
11 recovery was not probable under FAS 71 based on all
12 available evidence at the time, not after the fact, but
13 at the time. In other words, a mistake had been made.
14 What is the consequence for Deloitte & Touche?

15 A. There's no consequence for Deloitte &
16 Touche. If subsequent to the issuance of financial
17 statements somebody determines that there has been an
18 error in those financial statements, then the applicable
19 literature talks about how you go about correcting an
20 error if financial statements have been previously
21 issued.

22 Q. So if you investigate and do not, in fact,
23 base your opinion on all available evidence, there's no
24 consequence for your firm?

25 A. We do attempt to base our opinion on all

00410

1 evidence made available to us, and it's our role to try
2 to determine that we have all evidence available to us,
3 and we use that to base our opinion.

4 Q. Okay. And if you don't, then the rules are
5 that it would just simply -- the firm would simply
6 restate its financial reports based on the result that
7 it would have obtained had all the available evidence
8 been evaluated?

9 A. Well, by firm, I'm assuming you're referring
10 to the company.

11 Q. Yes.

12 A. If there is a subsequent event or a
13 subsequent discovery of facts that were available at the
14 time that an original judgment or opinion had been made,
15 then you would go about correcting that.

16 Q. Turn to page four of your testimony. On line
17 11, you state that:

18 Based on all the available evidence, we
19 concurred with the company's conclusion
20 that it was appropriate and in
21 accordance with generally accepted
22 accounting principles to defer power
23 costs as authorized by the Commission's
24 accounting order.

25 Do you see that?

00411

1 A. Yes, I do.

2 Q. And by this, you mean it was proper for the
3 company to record this as a regulatory asset on its
4 balance sheet?

5 A. Yes.

6 Q. And none of your analysis of the available
7 evidence was reduced to writing, was it?

8 A. Not that I recall.

9 Q. Could you turn to -- excuse me.

10 And beginning on line 16 of page 4, you
11 identify the available evidence that you reviewed; is
12 that correct?

13 A. That's correct.

14 Q. I would like to refer you to Exhibit 351 and
15 352. Do you have those?

16 A. Yes, I do.

17 Q. And in Exhibit 351, the Staff asked a data
18 request for all, in item two:

19 All documents actually considered by the
20 independent auditors that were used to
21 determine that such booking treatment
22 was proper.

23 This refers to the regulatory asset
24 treatment. And the response was down below, refers us
25 to the response to the first item, which was that:

00412

1 The company provided official filings
2 that the company made with the
3 Commission and the official findings of
4 the Commission.

5 Do you see that?

6 A. Yes, I do.

7 Q. And then it refers us on to Staff Request 99,
8 right?

9 A. That's what it says.

10 Q. And if you refer to Exhibit 352, which is the
11 response to Staff Data Request 99, and did you have a
12 chance to review this before you took the stand?

13 A. Yes, I did.

14 Q. And am I correct that the only other
15 documents identified in Exhibit 352 were the -- in fact,
16 it says on the last paragraph:

17 No documents other than official filings
18 with the Commission have been provided
19 to the company's outside auditors.

20 Do you see that?

21 A. Yes, I do.

22 Q. It also says in the last sentence that you
23 reviewed the company's first and second quarter 10-Qs
24 also filed with the SEC. Do you see that?

25 A. Yes, I do.

00413

1 Q. Did you review the company's third quarter
2 2000 10-Q?

3 A. Yes, we did.

4 Q. So the -- if I -- am I correct then that the
5 -- other than the documents that are listed in these
6 exhibits that were provided to you by the company, which
7 are described in those exhibits, you also reviewed FAS
8 71, the FERC chart of accounts, and the Staff memo; is
9 that correct?

10 A. That's correct.

11 Q. And by in your testimony on page four where
12 you refer to the Staff memo, that was the memo that was
13 filed in connection with the Commission's August 9th,
14 2000, accounting order?

15 A. That's correct.

16 Q. And the petition was the petition that led to
17 that accounting order?

18 A. Yes.

19 Q. And the order is also the August 9th order?

20 A. Yes.

21 Q. Okay. And that's the universe of documents
22 that you actually reviewed?

23 A. Yes.

24 Q. You are aware that Staff expressed to
25 Deloitte & Touche and to Avista that it had significant

00414

1 concerns about Avista's booking deferred power costs as
2 a regulatory asset, correct?

3 A. At what time?

4 Q. At any time. Well, let me just ask when you
5 first became aware of that?

6 A. That the Staff had concerns?

7 Q. Yes.

8 A. It was recently.

9 Q. Was it in January of this year?

10 A. I don't recall.

11 Q. Your team never independently followed up
12 with Staff about that, did it?

13 A. No, we did not.

14 Q. On the last line of page four of your
15 rebuttal, you say that you drew on your other
16 experiences and tried to compare this issue with
17 analogous situations you may have seen elsewhere. Do
18 you see that?

19 A. Yes, I do.

20 Q. That analysis was not reduced to writing
21 either, was it?

22 A. That's correct.

23 Q. And it wasn't based on a review of any
24 documents, was it?

25 A. No specific documents.

00415

1 Q. Did you investigate any of this Commission's
2 orders other than the accounting orders in Docket
3 UE-000972?

4 A. You mean specific orders, not that I recall.

5 Q. Did Deloitte & Touche conduct any
6 independent analysis of the prudence of Avista's power
7 purchases?

8 A. We reviewed the power purchases.

9 Q. Did you conduct an independent analysis of
10 the prudence of those purchases?

11 A. Not of the prudency per se.

12 Q. Did you apply a presumption of prudence to
13 Avista's power cost deferrals in reaching your opinion?

14 A. Yes, we discussed the power cost deferrals
15 with the company. We reviewed through the books and
16 records the expenditures, what the company was spending
17 money on. And in reviewing what they were expending
18 their money on, in discussing with the company, and an
19 understanding in the industry of what was going on, we
20 concurred with their conclusion that these were prudent.

21 Q. But you didn't conduct an independent
22 analysis of prudence?

23 A. That's correct.

24 Q. You recall, do you not, that the Commission
25 in its August 9th, 2000, order indicated that the

00416

1 company beared the burden of proof that recovery of
2 these deferred power costs through a deferral mechanism
3 is appropriate?
4 A. Yes.
5 Q. And is that a material issue?
6 A. Yes.
7 Q. And that issue was disclosed in the company's
8 10-K, was it not?
9 A. Yes, it was.
10 Q. Do you know why that was not disclosed in the
11 company's November 14th, 2000, 10-Q?
12 A. I don't have the 10-Q with me to refer to. I
13 don't recall.
14 Q. Would you accept subject to check that it was
15 not?
16 A. I will accept that.
17 Q. And assuming that, do you know why it was
18 not?
19 A. No, I don't.
20 Q. Turn to page 3 of your testimony, and
21 beginning on line 11, you quote a portion of F-A-S or
22 FAS 71, is that right?
23 A. Yes.
24 Q. As related to a company's financial
25 statements to the public, a company such as Avista must

00417

1 follow generally accepted accounting principles or GAAP,
2 G-A-A-P, correct?

3 A. That's correct.

4 Q. And financial accounting standards or
5 statements such as FAS 71 are the highest level and
6 authority in the pronouncement of GAAP, correct?

7 A. That's correct.

8 Q. For financial statements that require GAAP
9 accounting such as the annual report to stockholders, a
10 company such as Avista is generally not allowed to defer
11 expenditures that would normally be expensed in the
12 current period, correct, as a general matter?

13 A. A company such as Avista as a regulated
14 enterprise would follow FAS 71, and if there is a belief
15 that an asset or an expenditure is recoverable in a
16 future period, they have the ability under FAS 71 to
17 defer that expenditure as a regulatory asset.

18 Q. So FAS 71 can we say is the exception to the
19 general rule?

20 A. It's a part of the rules. There are a
21 variety of rules out there within FASB, a variety of
22 financial statements. Some apply to certain industries,
23 some are very industry specific, some are not. So it's
24 not an exception to the general rule, it is a rule that
25 applies to Avista.

00418

1 Q. Absent FAS 71, the company would not be
2 allowed to defer expenditures that would normally be
3 expensed in the current period, correct?

4 A. Not necessarily. Prior to FAS 71, it was
5 what was referred to as the Amendment to Opinion 2, so
6 there has been literature out there for quite a while
7 that has referred to accounting for regulated
8 enterprises.

9 Q. FAS 71 replaced that opinion?

10 A. Yes, it did.

11 Q. And assuming neither of those opinions
12 existed, the general rule would be that you can't
13 expense, you can't capitalize items that would normally
14 be expensed in the current period?

15 A. As a general rule, that's correct.

16 Q. And you mentioned that it is possible with
17 regard to regulated entities to comply with FAS 71 and
18 defer expenditures that would otherwise be expensed in
19 the current period?

20 A. That's correct.

21 Q. A regulatory Commission does not make the
22 decision that its action to allow the company to defer
23 an item on its financial statements creates a regulatory
24 asset on the company's financial statements to the
25 public; is that right?

00419

1 A. I apologize, can you please reread that?

2 Q. I may have missed a word. A Commission does
3 not make the decision that its action to allow a company
4 to defer an item on its regulatory financial statements
5 constitutes the creation of an asset on a company's
6 financial statements to the public, correct?

7 A. That's correct.

8 Q. And so in order for a company to be able to
9 record a deferral related to regulatory action in its
10 GAAP statements, the deferrals must meet FAS 71?

11 A. That's correct.

12 Q. And here on page three, you quote part of FAS
13 71, and there are two criteria, both of which must be
14 met; is that right?

15 A. Yes.

16 Q. And the first is that it is probable that
17 future revenue in an amount at least equal to the
18 capitalized cost will result from inclusion of that cost
19 in allowable costs for rate making purposes, correct?

20 A. Yes.

21 Q. And the deferrals of power costs in this case
22 are what are referred to as capitalized costs, correct?

23 A. Yes.

24 Q. So first, a company would have to demonstrate
25 that it was probable that inclusion of the deferred

00420

1 costs in rate proceedings would result in future
2 revenues intended to recover the deferred costs as
3 opposed to future costs?

4 A. That's correct.

5 Q. And second, that the revenues generated by
6 the inclusion of the deferred costs in a rate making
7 proceeding would have to be at least equal to the
8 deferrals, correct?

9 A. That's correct.

10 Q. The term used in FAS 71, a term is probable,
11 and you on page four of your testimony refer to this as
12 a "only a standard of probability, something that can be
13 reasonably expected or believed." Do you see that?

14 A. Yes, I do.

15 Q. If the recovery of a specific deferred
16 expense is probable for only 75% of that deferred
17 expense and not probable for the rest of that deferred
18 expense, then only 75% of that deferred cost could be
19 recognized as a regulatory asset, correct?

20 A. Assuming that you were able to do an analysis
21 to determine that it was probable with respect to 75%
22 and not with respect to 25%, that's correct. 75% would
23 be capitalized as a regulatory asset. 25% would be
24 written off.

25 Q. On page 3 of your testimony on line 21 to 22,

00421

1 you say that reasonable assurance it says can be given,
2 but there are always matters such as prudence to be
3 determined prior to including a cost in rates. Do you
4 see that?

5 A. Yes, I do.

6 Q. And by this, do you mean that there need not
7 be a final prudence determination before a company may
8 book a regulatory asset?

9 A. That's correct.

10 Q. Under what circumstances would issues
11 regarding prudence of a cost prevent the recognition of
12 a regulatory asset?

13 A. If there were a belief that the costs were
14 not prudently incurred, if there were a belief that the
15 costs would not be allowed to be recovered in rates,
16 then you would not establish a regulatory asset.

17 Q. And you used prudence as an example here.
18 Would recoverability for any reason other than prudence,
19 if there was a substantial issue regarding
20 recoverability, would that impair the recognition of a
21 regulatory asset?

22 A. If there was a belief, again subject to
23 probability, that an incurred cost would not be
24 recovered in rates, then it would not be established as
25 a regulatory asset.

00422

1 Q. And as far as you're concerned, that belief
2 needs to be based on all available evidence?

3 A. That's correct.

4 Q. You indicated that in your review you
5 reviewed the FERC system of accounts; do you recall
6 that?

7 A. Yes.

8 Q. Is it correct that this Commission has the
9 authority to allow a company to defer costs for future
10 consideration for FERC accounting purposes?

11 A. Yes.

12 Q. And if that authority is given, that does not
13 necessarily mean that those deferrals meet the
14 requirements of FAS 71, correct?

15 A. That's correct.

16 Q. Are you aware that Deloitte & Touche was
17 contacted by Staff in November of last year regarding
18 the regulatory asset issue?

19 A. I don't recall that.

20 Q. Was Mr. Derrick, D-E-R-R-I-C-K, Coder,
21 C-O-D-E-R, on your team at that time?

22 A. Yes, he was.

23 Q. Do you recall him referring to you a contact
24 from Staff on the issue?

25 A. I don't recall.

00423

1 MR. TROTTER: Nothing further, thank you.
2 JUDGE MOSS: Mr. Van Cleve, anything for this
3 witness?
4 MR. VAN CLEVE: No questions, Your Honor.
5 JUDGE MOSS: Mr. ffitch?
6 MR. FFITCH: No questions, Your Honor.
7 JUDGE MOSS: Bench?

8
9 E X A M I N A T I O N

10 BY CHAIRWOMAN SHOWALTER:

11 Q. Is it a fair summary of your testimony to say
12 that you recognize that we have made no determination
13 about prudence or recoverability, but despite that fact,
14 based on your review of the company's records and
15 purchases and your understanding of the general
16 environment in which the company is operating, that you
17 are making an educated guess that the company will
18 recover these amounts substantially. Is that an
19 approximate summary of your testimony?

20 A. I prefer to think of it as a judgment rather
21 than --

22 Q. Okay, a judgment.

23 A. To be fair.

24 Q. Well, an informed by you and what you know as
25 opposed to what we have decided, I guess?

00424

1 A. Yes, and I think that to try to clarify, the
2 company's responsible for the financial statements.
3 We're not. Our role is to offer the company advice, to
4 be experts in accounting, to help them understand how
5 something might be accounted for. It's our role to
6 understand the environment, understand what's going on,
7 and to exercise judgment in trying to determine how
8 something's accounted for and how something is not. As
9 we mentioned, we have these FASB rules, and I see you've
10 got a rather thick book there, and that's only part of
11 them. Some rules apply to some companies, some rules
12 don't based upon the circumstances of the industries.

13 We understand that in a regulatory
14 environment, a regulator has the ability to establish a
15 regulatory asset. They also have the ability to
16 establish a liability. But a regulator establishes an
17 asset or a liability for regulatory purposes, may or may
18 not establish an asset or liability for GAAP purposes.
19 The two are different. With all due respect, the
20 Financial Standards Board did state that in, as was
21 mentioned, that regulators can tell the company what to
22 do for regulatory purposes, but GAAP is different.

23 But GAAP then relies on the economic impacts
24 of the regulators' decisions. GAAP takes a look at what
25 is the economic impact of a decision, and how do we then

00425

1 account for that economic impact, is it reasonable to
2 believe that there will be recovery of these costs, is
3 that a reasonable presumption that there will be
4 recovery of these costs, and that's how we determine our
5 judgment.

6 Q. And that's what you were guided by, FAS 71,
7 when you were going through that exercise?

8 A. Yes.

9 Q. Of your judgment?

10 A. Yes.

11 Q. All right. Now I am not an accountant.

12 A. Be grateful.

13 Q. But I have been handed the Miller GAAP Guide,
14 Restatement and Analysis of Current FASB Standards, year
15 2000. And it actually does not even have page numbers
16 in this big book, and so I am reading from something
17 that says 55.06, Regulated Industries. I imagine that's
18 a reference to a section of --

19 A. Yes.

20 Q. -- of GAAP?

21 A. Yes.

22 Q. And it is a discussion of FAS 71 in general
23 articulating the discussion we just had that under GAAP,
24 companies and their accountants can make judgments about
25 whether their judgment and expenditure is reasonable.

00426

1 A. Yes.

2 Q. Which is independent from our judgment at a
3 later point.

4 A. That's correct.

5 Q. But on this particular page, it says, and I'm
6 quoting:

7 The following conditions govern the
8 application of FAS 71:

9 And I will read the three, and my question to
10 you is going to be on the third. It says:

11 FAS 71 applies only to financial
12 statements.

13 I should have said:

14 Number 1, FAS 71 applies only to
15 financial statements issued for external
16 general purposes, not to financial
17 statements submitted to a regulatory
18 agency.

19 Number 2, FAS 71 shall be applied only
20 to regulated enterprises or those
21 portions of the operations of a
22 regulated enterprise that meet the
23 specific criteria established by FAS 71.

24 And Number 3, FAS 71 does not apply to
25 emergency governmental actions that are

00427

1 imposed under unusual circumstances such
2 as price controls during periods of high
3 inflation.

4 So my question to you is, do you know what
5 that means? It's very odd. Obviously it doesn't apply
6 to a governmental action, because FAS doesn't apply to
7 governmental actions. But do you know what that means
8 in this context?

9 A. Yes, I believe that that came out -- you have
10 to take a look at when FAS 71 was issued, which was in
11 1982, and when we go back to those times, we had high
12 inflation, we had the government talking about price
13 controls, et cetera, so there was a very broad context
14 in which the government was talking about we want to
15 control prices, et cetera, but it didn't have to do with
16 a regulated enterprise. It was the government coming in
17 and controlling enterprise in general or attempting to
18 put some type of price controls on enterprises in
19 general. And FAS 71 put that in there just to make sure
20 that people understood that this was really for
21 regulated enterprises such as a utility but was not for
22 enterprises in general.

23 Q. Oh, in other words, let's say the President
24 imposed prices at the gas pump.

25 A. Yes.

00428

1 Q. Then that would not be -- that would not make
2 gas stations a regulated entity to which FAS in general
3 applies?

4 A. Exactly.

5 Q. Or FAS 71 applies?

6 A. That's correct.

7 Q. I see now, because part of a discussion
8 surrounding those points was how do you know when
9 something is regulated or not.

10 A. Yes.

11 Q. And the discussion makes the point that FAS
12 and GAAP don't lay out, you know, electricity and
13 railroads are regulated, that it's a functional test.

14 A. That's correct.

15 Q. So your point is that three here is that just
16 because there's a price control somewhere doesn't mean
17 that suddenly it's a regulated entity subject to these
18 rules?

19 A. Yes.

20 CHAIRWOMAN SHOWALTER: All right, thank you,
21 I have no further questions.

22

23 E X A M I N A T I O N

24 BY JUDGE MOSS:

25 Q. Mr. Hoover, just a clarifying question for my

00429

1 benefit, please. While we may be thankful we're not
2 accountants and you may be thankful that you are not a
3 student of the law, we nevertheless have some parallels.
4 And as I understand your testimony, the determination of
5 probability in connection with this FAS 71 is, as I
6 understood what you said, involves the exercise of
7 judgment and the statement of opinion.

8 A. That's correct.

9 Q. And we also are in the business of exercising
10 judgment and stating opinion, and we follow various
11 standards in the law such as preponderance of the
12 evidence, which is sometimes described as more likely
13 than not or 51% versus 49% if you could lay it that
14 precisely; clear and convincing, which is a much higher
15 standard; beyond a reasonable doubt, the highest
16 standard yet.

17 A. Mm-hm.

18 Q. I suppose certainty would be the highest
19 standard, and that's seldom achieved. Are there similar
20 statement criteria that you use in terms of probability
21 along those lines in your business?

22 A. Yes, there are, that's referred to as FASB
23 Number 5, Accounting for Contingencies, and the criteria
24 that they lay out in there talks about remote, possible,
25 and probable, and it probably falls -- probable in that

00430

1 range probably falls within the range of what you were
2 talking about is, you know, 51% versus certain. It does
3 -- there are -- it talks about the fact that it is more
4 than likely but not certain.

5 JUDGE MOSS: Okay, thank you very much.

6 Mr. Meyer, I believe we're back to any
7 redirect you may have.

8 MR. MEYER: And I have no redirect, thank
9 you.

10 JUDGE MOSS: And, Mr. Hoover, we appreciate
11 you coming and visiting with us today, and you are
12 released from the stand.

13 I should have done this while Mr. Hoover was
14 still on the stand, but he need not return.

15 Mr. Trotter, I don't believe you moved your
16 exhibits. Did you wish to do that?

17 MR. TROTTER: I so move 351 and 352.

18 JUDGE MOSS: Hearing no objection, those
19 exhibits will be admitted as marked.

20 And, let's see, I believe we have Mr. Falkner
21 next.

22 MR. MEYER: Yes, call to the stand Mr. Donald
23 Falkner.

24

25 (The following exhibits were identified in

00431

1 conjunction with the testimony of DONALD M. FALKNER.)
2 Exhibit 250-T is Pre-filed direct testimony.
3 Exhibit 251 is DMF-1: Surcharge Revenue Requirement
4 Calculation - Washington Jurisdiction. Exhibit 252-T is
5 Pre-filed rebuttal testimony. Exhibit 253 is Staff
6 Cross-Exam Exhibit: Falkner Workpapers - Set 1. Exhibit
7 254 is Staff Cross-Exam Exhibit: Falkner Workpapers -
8 Set 2. Exhibit 255 is Staff Cross-Exam Exhibit: Falkner
9 Workpapers - Set 3.

10

11 Whereupon,

12

DONALD M. FALKNER,

13

having been first duly sworn, was called as a witness

14

herein and was examined and testified as follows:

15

16

MR. MEYER: Before we proceed, we do have one
17 last minute edit. This goes to Mr. Falkner's rebuttal
18 testimony, page 12 of Mr. Falkner's rebuttal.

19

JUDGE MOSS: Yes.

20

MR. MEYER: Line two.

21

JUDGE MOSS: I'm not there yet, give me a
22 minute. I need to rearrange my exhibit list. What is
23 his testimony, 250-T?

24

MR. MEYER: 252-T.

25

JUDGE MOSS: 252, thank you.

00432

1 MR. MEYER: This is rebuttal.
2 JUDGE MOSS: And page 12?
3 MR. MEYER: Yes, line two.
4 JUDGE MOSS: Give us a moment. We're there.
5 MR. MEYER: Okay. It reads, no, period, I do
6 not agree that a, et cetera, et cetera. The word not
7 should be eliminated.
8 JUDGE MOSS: Anything else?
9 MR. MEYER: No, but that does change the
10 meaning of that.
11 JUDGE MOSS: Yes, it does.
12 MR. MEYER: Okay. Those are all the
13 corrections.
14 With that then --
15 CHAIRWOMAN SHOWALTER: Commissioner Hemstad
16 probably remembers because he may have been Governor
17 Evans' legal counsel when Governor Evans vetoed the word
18 not out of a law.
19 COMMISSIONER HEMSTAD: I didn't agree with
20 that veto.
21
22 D I R E C T E X A M I N A T I O N
23 BY MR. MEYER:
24 Q. Mr. Falkner, if I were to ask you the
25 questions that appear in your pre-filed direct marked as

00433

1 250-T and your rebuttal 252-T and with the correction
2 having just been made to your rebuttal testimony, would
3 your answers be the same?

4 A. Yes, they would.

5 Q. Are you also sponsoring what has been marked
6 for identification as Exhibit 251?

7 A. Yes, I am.

8 Q. Is the information in that exhibit true and
9 correct to the best of your knowledge?

10 A. Yes, it is.

11 MR. MEYER: With that, Your Honor, I move the
12 admission of 250-T, 251, and 252-T.

13 JUDGE MOSS: Hearing no objection, those
14 exhibits will be admitted as marked.

15 MR. TROTTER: Your Honor, can we go off the
16 record for a discussion of the version of this that I
17 have.

18 JUDGE MOSS: Yes, we will be off the record.
19 (Discussion off the record.)

20 MR. TROTTER: Shall I begin?

21 JUDGE MOSS: All right, is the witness
22 available for cross-examination? I apologize, I lost
23 the flow here momentarily.

24 MR. MEYER: Yes.

25 JUDGE MOSS: Mr. Trotter, go ahead.

00434

1

2

C R O S S - E X A M I N A T I O N

3

BY MR. TROTTER:

4

Q. Mr. Falkner, part of your rebuttal testimony discusses Staff's accounting recommendations with regard to surcharge revenue and covenant calculations, correct?

7

A. Yes, it does.

8

Q. And are you relying on Mr. Peterson's testimony for that?

10

A. Mr. Peterson's testimony as well as I have reviewed portions of the covenants myself.

11

12

Q. Do you disagree with Mr. Peterson's

13

testimony?

14

A. My recollection of Mr. Peterson's testimony is that accounting for the surcharge revenues as proposed by Staff would not provide the maximum benefit to the company in the company calculations, and I do agree with that.

15

16

17

18

19

Q. Do you agree with his statement that Staff's accounting proposal does not constitute "cash on the balance sheet" for purposes of the definition of consolidated cash flow?

20

21

22

23

A. I will agree with Mr. Peterson on that statement.

24

25

Q. And did you do any independent investigation

00435

1 of the definition of the term cash on the balance sheet
2 as used in that?

3 A. Not cash on the balance sheet, no. I looked
4 at the covenant calculations in regard to the
5 consolidated fixed charge coverage ratio. And it's in
6 that calculation where not reducing the deferral balance
7 is a detriment to the coverage calculation for the
8 company going forward.

9 Q. An increase of cash does benefit the company
10 going forward, does it not?

11 A. If it is used in the balance sheet, in some
12 way is reducing current debt or remains on the balance
13 sheet as cash available, then yes, it is a benefit.

14 Q. And it's true that other non-cash items
15 reducing consolidated net income can be included in the
16 definition of consolidated cash flow, correct?

17 A. Can you state that question again?

18 Q. Isn't it correct that the category of other
19 non-cash items reducing such consolidated net income is
20 included in the measurement of consolidated cash flow?

21 A. Yes, non-cash items that are a deduction to
22 net income can be added back in such as depreciation to
23 reach consolidated cash flow.

24 MR. TROTTER: Your Honor, Mr. Falkner's
25 testimony relates to rate design, and I understood in

00436

1 prior conversation with Mr. Meyer that he wishes those
2 questions to be deferred to Mr. Hirschhorn; is that
3 correct, Mr. Meyer?

4 MR. MEYER: That is correct.

5 BY MR. TROTTER:

6 Q. Mr. Falkner, I would like to refer you to
7 Exhibits 253, 254, and 255. Do you have those?

8 A. Yes, I do.

9 Q. And those are a portion of your work papers,
10 are they not?

11 A. These are work papers that were provided to
12 me by the power supply department, and they are used to
13 calculate their -- they are the deferral projections,
14 actuals, and projections, yes.

15 Q. Regardless of who prepared them, they were
16 contained in your work papers, weren't they?

17 A. Yes, they were.

18 Q. And you relied on them?

19 A. Yes, I did.

20 Q. Before we talk about those exhibits, I would
21 like to refer you to Exhibit 251.

22 A. I'm there.

23 Q. And on line 15, you show your total surcharge
24 revenue requirement of approximately \$87.4 Million?

25 A. Yes.

00437

1 Q. And is it correct that that figure is the \$80
2 Million figure on page ten grossed up for taxes and
3 other revenue sensitive items?

4 A. On page ten?

5 Q. Line ten, excuse me. Let me start over.

6 A. It's --

7 Q. The \$87 Million is derived by taking the
8 annual state surcharge before conversion factors on line
9 of some \$80.409 Million until -- and then combining
10 those conversion factors?

11 A. Correct.

12 Q. Okay. Then let's turn to Exhibit 253, page
13 1, and that \$80,409,000 figure is shown in the third
14 line of page 1, third column from the right?

15 A. Yes.

16 Q. And that figure is derived by finding a
17 percentage that results in the ending balance for
18 Washington being zero or close to zero by the end of the
19 27 month term?

20 A. Correct, that's the amortization level of the
21 power cost deferral balance necessary to reach zero at
22 the end of December 2003.

23 Q. Let's take December 2001 column as an
24 example. You start with the ending balance from
25 November, add \$5.764 Million as the new increment of

00438

1 deferral for December, subtract your proposed use of the
2 PGA amortization credit, subtract the surcharge to be
3 collected in December, add some interest for that month,
4 and that gives you the December ending balance, correct?

5 A. Correct, that would be PGE amortization. I
6 think you mentioned PGA.

7 Q. I meant to say PGE, thank you.

8 Let's continue with the example on Exhibit
9 254, page 1, the power costs Avista proposes to defer in
10 December 2001 are shown in the bottom right-hand corner
11 of the \$5.764 Million?

12 A. Correct.

13 Q. And you then just transferred that amount
14 over to Exhibit 253?

15 A. 253, correct, it's just a supporting
16 worksheet, yes.

17 Q. Okay. Turn to page 2 of Exhibit 254, and we
18 see on line 15 an entry for Coyote Springs capital and
19 O&M adjustment - system. Do you see that?

20 A. I do.

21 MR. MEYER: I'm sorry, that reference again?

22 MR. TROTTER: Page 2, line 15, Exhibit 254.

23 MR. MEYER: Thank you.

24 BY MR. TROTTER:

25 Q. And this shows, does it not, that beginning

00439

1 in July of 2002, Coyote Springs adds approximately \$3.3
2 Million per month to the deferral balance?

3 A. Actually, it shows it starting in June of
4 '02, but yes, that's correct. My worksheet shows it
5 line 15, the first entry of \$3.3 million is in June of
6 2002.

7 Q. I thought I said -- I meant to say June, I'm
8 sorry.

9 A. Okay. Yes, that's the expected operational
10 date for Coyote Springs.

11 Q. Now turn to Exhibit 255, page two.

12 A. Page two?

13 Q. Yeah. And does this sheet show the
14 calculation of the amounts of Coyote Springs that are
15 added to Avista's projected deferrals?

16 A. Yes, it does.

17 Q. And on the right-hand side of the page in the
18 lower right-hand corner, the second to last figure there
19 of \$23.125 Million, that's divided by seven, which is
20 the months in the year in which Coyote Springs was in
21 service, and that gets the \$3.3 million a month that
22 then appears on the prior exhibit?

23 A. That's correct. And as we noted before, this
24 is the projected period. Any surcharge revenues we
25 would get from the Commission would be adjusted for

00440

1 actuals. And there will probably be some adjustment
2 between now and June of 2002 to take into account
3 anything that might come out of a general case or
4 whatever. So there's a chance these Coyote Springs II
5 revenues or charges wouldn't even be included in the
6 deferral balance.

7 Q. And there is a chance --

8 A. The ultimate deferral balance.

9 Q. And there is a chance they would, correct?

10 A. And there is a chance they would, correct.

11 Q. And the \$23 Million is derived by adding the
12 three columns to the left for total other expense,
13 return, and interest. Do you see that?

14 A. Yes, I do.

15 Q. And the return amount is \$5.868 Million,
16 correct?

17 A. Correct, and that was determined using the
18 most recently authorized rate of return from this
19 Commission.

20 Q. And you applied that to the capital invested
21 in Coyote Springs II?

22 A. Correct.

23 Q. And that rate of return was 9.03%?

24 A. Yes, it was. We were referring to the
25 settlement document that indicated all costs and all

00441

1 benefits of dealing with the power situation were to be
2 included in the deferral.

3 The benefits of Coyote are also in the
4 calculation of the deferral where any revenues, any
5 generation from the Coyote Springs project, any sales
6 revenue they provide, are also a reduction to the
7 deferral balance, the thinking being if we were to
8 include the revenues, we would include associated
9 expenses in the calculation.

10 Q. I think there's no question pending at the
11 moment.

12 A. Excuse me.

13 MR. TROTTER: Your Honor, if I could just
14 take a moment, I just need the confirmation of one
15 question.

16 Thank you, Your Honor.

17 BY MR. TROTTER:

18 Q. Pages, still with Exhibit 255, pages three
19 through seven show additional projects that are adding
20 to the deferral balance with in-service dates as shown
21 on each page in the upper left-hand corner, correct?

22 A. Yes, those would be the company's small
23 generation projects that have been discussed previously.

24 Q. And you don't consider Coyote Springs to be
25 in that category, do you?

00442

1 A. No.

2 MR. TROTTER: Your Honor, I would move for
3 the admission of Exhibits 253, 254, and 255.

4 JUDGE MOSS: Being no objection, those will
5 be admitted as marked.

6 BY MR. TROTTER:

7 Q. Mr. Falkner, could you turn to your direct
8 testimony on page six, and on line nine, you begin to
9 discuss the PGE credit treatment that the company is
10 proposing for the power cost deferrals, correct?

11 A. Correct.

12 Q. And you understand that the Commission has
13 ordered the regulatory treatment of a portion of the PGE
14 credit, which was to amortize it over a multiyear
15 period?

16 A. Correct, and they also noted that the
17 remaining portion that hadn't received final
18 determination was to be addressed at a future date.

19 Q. Turn to page seven, at line nine, you refer
20 to an amount of \$14,205,000, which you describe as the
21 amount that is a recognition of the time value of money
22 on the lump sum monetization payment by PGE received by
23 the company, correct?

24 A. That's my recollection of how it was
25 characterized during the general case.

00443

1 Q. And in its order in Docket UE-991606, your
2 last rate case, this \$14.2 Million was established by
3 the Commission as a credit against Washington electric
4 rate base to be amortized over eight years, correct?

5 A. It was included in the calculation, yes.

6 Q. Now this \$14.2 Million part of the PGE credit
7 amount is not proposed by Avista to offset the deferred
8 power costs, correct?

9 A. Correct.

10 Q. Is it correct that this \$14.2 Million is not
11 reflected on the company's balance sheet?

12 A. That's what I stated in testimony, yes.

13 Q. Avista's proposal regarding the PGE credit is
14 to deal only with the amounts reflected on its balance
15 sheet, which is some \$53.8 Million, and use that to
16 offset deferral balances?

17 A. Correct. The main purpose of the filing is
18 to address the deferral balance on the company's balance
19 sheet, and we determined it would be prudent to also
20 include the PGE deferrals that were on the balance
21 sheet. Basically if the deferrals are owed to the
22 company and the PGE credit is owed to customers, you can
23 offset the two and deal with the remainder through the
24 surcharge amount.

25 Q. Could you explain why the \$14.2 Million is

00444

1 not reflected on the company's balance sheet since the
2 Commission established it as a regulatory credit in its
3 order in the last rate case?

4 A. It was an amount that never had any bearing
5 on the PGE calculation itself. It wasn't part of the
6 deferred revenues. It was a calculation performed by
7 Staff that was included in the PGE amortization at the
8 -- in the final order. It had never had any reason to
9 be booked before.

10 Q. Well, after the order, why wasn't it booked?

11 A. It was determined to be just a -- not a
12 material amount in the overall calculation. The amount
13 is being recorded for regulatory purposes. It's part of
14 any credit that we use in a calculation of our revenue
15 requirement for the Commission. It didn't have a
16 material impact on the company's balance sheet.

17 Q. When you say it's not material in the amount
18 in the calculation, in the calculation of what?

19 A. The total PGE credit was in excess of \$150
20 Million. But more to the point, it's not material to
21 the company's balance sheet, which at that point in time
22 was in excess of \$7 Billion and at this point in time is
23 in excess of \$3 Billion. But it's not being ignored.
24 It is still being included in anything we provide the
25 Commission, and it's in our semiannual or I guess annual

00445

1 results of operations that we provide and would be
2 included in any future general case. So the credit is
3 there, and customers continue to receive any benefit
4 associated with it.

5 Q. Well, that's not my point. My question goes
6 to why it wasn't booked on the balance sheet, and your
7 answer is because it was not material.

8 A. Correct.

9 MR. TROTTER: One moment, please.
10 That's all I have, Mr. Falkner, thank you.

11 JUDGE MOSS: Thank you, Mr. Trotter.

12 Mr. Van Cleve, do you have questions for
13 Mr. Falkner?

14 MR. VAN CLEVE: Just a brief question, Your
15 Honor.

16

17 C R O S S - E X A M I N A T I O N

18 BY MR. VAN CLEVE:

19 Q. Mr. Falkner, could you refer to Exhibit DMF-1
20 to your direct testimony, which is Exhibit 251.

21 A. I'm there.

22 Q. Now at line 16, the approximately \$237
23 Million figure, does that represent the total amount
24 that would be collected under the surcharge on a
25 Washington basis if the surcharge was in effect for 27

00446

1 months?

2 A. No, there's no relation to those two items.

3 Q. What is the total amount that would be
4 collected?

5 A. If we implemented the surcharge as we
6 requested over 27 months?

7 Q. Right.

8 A. I don't know. It would be 87 divided by 27,
9 it would be 87 divided by 12 times 27, if I can make
10 this small calculator work, approximately \$196 Million.

11 Q. Can you tell me how much that number would
12 have to increase if the Staff proposal to not accelerate
13 the amortization of the PGE credit were adopted?

14 A. My recollection is the PGE credit was \$58
15 Million that we're using in this calculation, I should
16 use subject to check.

17 MR. MEYER: It's 54.

18 A. It has now been checked, so it would be \$54
19 Million, roughly \$4 1/2 Million, \$4 Million to \$5
20 Million.

21 Q. And it was your testimony, was it not, that
22 the rate increase would need to be approximately 48% if
23 the PGE credit was not accelerated? I think line 7,
24 page 24.

25 MR. MEYER: You mean -- I think you've got it

00447

1 reversed, page 7, line 24, so.

2 MR. VAN CLEVE: Sorry.

3 MR. MEYER: Of your direct.

4 A. Correct.

5 MR. VAN CLEVE: That's all I have.

6 MR. FFITCH: No questions, Your Honor.

7 JUDGE MOSS: All right.

8 Any questions from the Bench for Mr. Falkner?

9 CHAIRWOMAN SHOWALTER: I have just one.

10

11 E X A M I N A T I O N

12 BY CHAIRWOMAN SHOWALTER:

13 Q. Can you turn to your rebuttal testimony, page
14 12, Exhibit 252.

15 A. I'm there.

16 Q. Line 11, you mention industrial, commercial,
17 and institutional customers. Who are your institutional
18 customers, or what are they generally, and who are they
19 in particular?

20 A. I'm going to have to defer that to
21 Mr. Hirschhorn.

22 Q. Okay.

23 A. I would assume those might be any hospitals
24 for the most part, but I'm going to defer that to
25 Mr. Hirschhorn.

00448

1 CHAIRWOMAN SHOWALTER: All right, thank you,
2 that's all I have.

3 JUDGE MOSS: All right, do you have any
4 redirect?

5 MR. MEYER: Just briefly.

6

7 R E D I R E C T E X A M I N A T I O N

8 BY MR. MEYER:

9 Q. Staff during its cross-examination explored
10 the accounting of the surcharge to revenues under
11 Staff's proposal and impact on covenants. Mr. Falkner,
12 in your estimation, would it make it more difficult for
13 the company to persuade its banks that it has satisfied
14 its covenants if Staff's accounting for surcharge
15 revenues as a liability were adopted?

16 A. Oh, yes, it would. There's -- the banks are
17 looking for the deferral balance to be addressed in some
18 way. The surcharge is one of the -- is the filing as of
19 now to reduce the deferral balance. If we are allowed
20 to increase rates but not impact the deferral balance,
21 the banks would see that as not addressing the issue of
22 the deferral balance. And more to the point, it doesn't
23 give the company much of a basis for even booking the
24 revenues. It almost appears to be a short term loan of
25 90 days, and the way I read it, we wouldn't even be

00449

1 supported by GAAP in recording the revenues into a
2 liability account.

3 The current accounting standards say -- they
4 do address regulated enterprises getting revenues
5 subject to refund. The assumption is that those we
6 booked as revenues, and FAS 71 even addresses that,
7 there's no discussion about recording them in a
8 liability. What FAS 71 does go on to say is that after
9 you start booking them as revenues as ordered, since you
10 are increasing customer rates, then you can make a
11 second determination, should we record a contingent
12 liability. The company must make a determination as we
13 start booking those revenues, are we going to be able to
14 retain them, would we actually have to refund them
15 somewhere down the road. And as Mr. Hoover mentioned,
16 that FAS 5 accounting for contingencies comes into play.

17 If we were to take the Staff approach and
18 book 100% of the subject to refund revenues as a
19 liability, we're basically making the determination that
20 we won't be able to retain any of those down the road.
21 According to GAAP, we would have had to have made a
22 determination to probability that we would refund all of
23 those moneys. If we record it as a liability, the GAAP
24 literature basically states that you have determined you
25 can't keep it.

00450

1 And that even applies -- it goes to the
2 question or the amount, the materiality. If we put this
3 surcharge in place for three months, we collect roughly
4 \$20 Million. We're talking about a balance of \$150
5 Million right now projected to go to \$200 Million, and
6 we would only be talking about 10%. We would have had
7 to make the determination with taking all the
8 information into account that the company wouldn't even
9 be able to collect 10% of the total deferrals projected
10 to be on the books by the end of this year. And that in
11 the company's determination wouldn't be a reasonable
12 result.

13 Q. Well, Mr. Falkner, are you saying that under
14 FAS Statement 5 that we would only book a surcharge
15 revenues as a liability if it was probable that a refund
16 would be ordered?

17 A. Correct.

18 MR. MEYER: Okay, I believe that's all I
19 have, thank you.

20 MR. TROTTER: I have a couple of follow ups,
21 Your Honor.

22 JUDGE MOSS: Go ahead, Mr. Trotter.

23 MR. TROTTER: Thank you.

24

25

00451

1 R E C R O S S - E X A M I N A T I O N

2 BY MR. TROTTER:

3 Q. Does Avista understand that the
4 recoverability of deferred power costs is subject to the
5 conditions that the Commission sets forth in its
6 accounting order?

7 A. The company completely understands what was
8 in the Staff memo, what was in the Commission orders.
9 At the same time, we have the ability to make a
10 determination of what we think might be a reasonable
11 conclusion from this case.

12 Q. Do I understand correctly that if you
13 believed that you would actually have to refund moneys
14 that are collected, that you have to -- you could not
15 book those revenues?

16 A. Correct, if we believe that any revenues from
17 this case that are subject to refund that we won't be
18 able to keep, we would have to record those as a
19 liability.

20 MR. TROTTER: Thank you, that's all I have.

21 JUDGE MOSS: I believe that will complete our
22 questioning of Mr. Falkner, so appreciate you being with
23 us today and release you subject to recall, as I have
24 all the other witnesses. Thank you.

25 THE WITNESS: Thank you.

00452

1 JUDGE MOSS: Have we found the missing
2 witness?
3 MR. MEYER: We have.
4 JUDGE MOSS: So you are calling to the stand
5 Mr. Hirschhorn?
6 MR. MEYER: I am.
7 MR. VAN CLEVE: Your Honor, we have a couple
8 of questions for Mr. Hirschhorn in a cross exhibit.
9 JUDGE MOSS: This is a new exhibit?
10 MR. VAN CLEVE: Yes, it is.
11 JUDGE MOSS: It will be marked as 302.

12

13 (The following exhibits were identified in
14 conjunction with the testimony of BRIAN J. HIRSCHKORN.)

15 Exhibit 300-T is Pre-filed direct testimony.
16 Exhibit 301 is BJH-1: Proposed Power Cost Surcharge
17 Rates by Schedule, State of Washington, Based on 2000
18 Pro Forma Revenue and October 2001 - September 2002
19 Forecast kwhs.

20

21 Whereupon,

22

23 BRIAN J. HIRSCHKORN,
24 having been first duly sworn, was called as a witness
25 herein and was examined and testified as follows:

00453

1 D I R E C T E X A M I N A T I O N

2 BY MR. MEYER:

3 Q. Mr. Hirschhorn, for the record, please state
4 your name and your employer.

5 A. My name is Brian Hirschhorn, and I'm employed
6 by Avista Corporation.

7 Q. And have you prepared pre-filed direct
8 testimony?

9 A. Yes, I have.

10 Q. If I were to ask you the questions that
11 appear in that testimony, would your answers be the
12 same?

13 A. Yes, they would.

14 MR. MEYER: With that, I move the admission
15 of Exhibit 300-T.

16 BY MR. MEYER:

17 Q. Mr. Hirschhorn, you also have sponsored what
18 has been marked for identification as Exhibit 301,
19 correct?

20 A. Yes, that's correct.

21 Q. And does that exhibit contain true and
22 correct information to the best of your knowledge?

23 A. Yes, it is.

24 MR. MEYER: I also move the admission of 301.

25 JUDGE MOSS: Being no objection, those will

00454

1 be admitted as marked.

2 MR. MEYER: Thank you.

3 The witness is available for cross.

4 JUDGE MOSS: Mr. Trotter.

5 MR. TROTTER: Thank you. I did not indicate
6 questions for him, but since there has been deferral
7 from Mr. Falkner, I do have some now.

8 JUDGE MOSS: Go ahead.

9

10 C R O S S - E X A M I N A T I O N

11 BY MR. TROTTER:

12 Q. Mr. Hirschhorn, is Avista relying on any
13 Commission order granting interim rate relief which that
14 relief was granted on a uniform percentage basis as you
15 proposed it?

16 A. No, the company is not relying on any
17 Commission order.

18 Q. And, in fact, the orders that you're aware of
19 consistently granted interim rate relief on the basis of
20 uniform cents per kilowatt hour basis?

21 A. To my knowledge, I believe that's true.

22 Q. Now the company's proposed tariff that it
23 filed in this case does not bear the December 31st,
24 2000, termination date proposed by the company, but the
25 company is not opposed to including that; is that

00455

1 correct?

2 A. No, the company is not opposed to including
3 that date.

4 CHAIRWOMAN SHOWALTER: What was the date?

5 MR. TROTTER: December 31, 2003. That's the
6 company's proposal.

7 BY MR. TROTTER:

8 Q. And the --

9 CHAIRWOMAN SHOWALTER: I'm sorry, what was --
10 I just didn't hear the question. What is the date to
11 which the witness does not object?

12 MR. TROTTER: Putting that date in the
13 tariff. The tariff currently has no termination date.

14 BY MR. TROTTER:

15 Q. And also the proposed tariff does not
16 explicitly state that the charges imposed are subject to
17 refund, but am I correct in understanding the company is
18 not opposed to adding that language?

19 A. That's correct.

20 MR. TROTTER: Those are all my questions,
21 thank you.

22 JUDGE MOSS: Mr. Van Cleve.

23

24

25

00456

1 C R O S S - E X A M I N A T I O N

2 BY MR. VAN CLEVE:

3 Q. Mr. Hirschhorn, could you please refer to
4 Exhibit 302, which is an Avista response to Staff Data
5 Request 128.

6 A. Yes, I have that.

7 Q. Is this a data response that you prepared?

8 A. Yes, it is.

9 Q. And if you could turn to the second page of
10 that, of Exhibit 302.

11 A. I have that.

12 Q. Can you explain what this table is trying to
13 depict?

14 A. Yes, it's a comparison of the company's
15 proposal to spread the surcharge on a uniform percentage
16 basis to all customer schedules compared to applying the
17 surcharge on an equal cents per kilowatt hour basis.
18 Column four shows the uniform percentage basis, and
19 column eight shows what the percentage increase by
20 various rate schedule would be applying the surcharge on
21 an equal cents per kilowatt hour basis.

22 Q. Now is column five the annual dollar amount
23 on an equal cents per kilowatt hour basis?

24 A. Yes, it is.

25 Q. Okay. And Schedule 1, is that the schedule

00457

1 that applies to residential rate payers?

2 A. Yes, the majority or nearly all of our
3 residential customers are served under Schedule 1.

4 Q. And is the company proposing to offset the
5 residential rate increase with a credit from the BPA
6 settlement?

7 A. Yes.

8 Q. And that would happen at the same time that
9 the rate surcharge goes into effect?

10 A. The company is proposing that the Bonneville
11 residential credit be applied at the same time the
12 surcharge goes into effect, yes.

13 Q. So what would be the net effect of the
14 surcharge and Bonneville credit for Schedule 1
15 customers?

16 A. I have that number in my direct testimony,
17 which was revised via an errata sheet that was submitted
18 by the company. The effect generally on a residential
19 customer that uses 1,000 kilowatt hours a month would be
20 about a 26% net increase applying the surcharge as well
21 as the Bonneville credit.

22 Q. So if the Commission approves the surcharge
23 effective September 15th but adopts the equal cents per
24 kilowatt hour basis on September 15th, residential rates
25 would go up 26%, and the Schedule 25 rates would go up

00458

1 approximately 55%; is that correct?

2 A. Yes, on an equal cents per kilowatt hour
3 basis, that would be correct.

4 Q. And how many Schedule 25 customers are there?

5 A. There's about 20.

6 Q. So on an equal cents per kilowatt hour basis,
7 the rates for those 20 customers would increase on an
8 annual basis by about \$9.7 Million?

9 A. The average increase for those customers --
10 the average increase for those customers would be 55%.

11 Q. And that would be about \$9.7 Million per
12 year, Mr. Hirschhorn?

13 A. Yes, that's correct.

14 Q. Have you analyzed what the rate increase by
15 customer class would be without an acceleration of the
16 PGE amortization, but with an equal cents per kilowatt
17 hour allocation?

18 A. No, I have not.

19 Q. Would you expect that the Schedule 25 rate
20 increase would be higher than 55% if the PGE credit is
21 not accelerated?

22 A. Yes. I might make a correction. The numbers
23 shown in column five on the response to the data request
24 we were just looking at that shows a comparison of the
25 uniform percentage to the equal cents per kilowatt hour,

00459

1 I believe the dollars shown in column five are -- would
2 be the revenue increase based on the uniform percentage,
3 not on an equal cents basis.

4 Q. Mr. Schoenbeck informs me that the number on
5 an equal cents per kilowatt hour basis would be
6 approximately \$14 1/2 Million, would you -- for the
7 Schedule 25 rate increase. Would you agree to that
8 subject to check?

9 A. Subject to check, yes.

10 Q. So subject to check, the 54.8% rate increase
11 under the equal cents per kilowatt hour allocation would
12 be \$14.5 Million that would be paid by those 20
13 customers on an annual basis?

14 A. Yes, that's correct, subject to check.

15 MR. VAN CLEVE: Your Honor, I would offer
16 Exhibit 302.

17 JUDGE MOSS: Hearing no objection, it will be
18 admitted as marked.

19 MR. VAN CLEVE: That's all the questions that
20 I have.

21 JUDGE MOSS: Mr. ffitch.

22 MR. FFITCH: Thank you, Your Honor.

23

24

25

00460

1 C R O S S - E X A M I N A T I O N

2 BY MR. FFITCH:

3 Q. Good morning, Mr. Hirschhorn.

4 A. Good morning.

5 Q. First, just to follow up on a question from
6 Mr. Van Cleve with regard to Exhibit 302. If you could
7 take that exhibit and look at column seven and at the
8 line for Schedules 41 to 49, it's currently blank,
9 correct?

10 A. Yes, it is.

11 Q. Can you fill in that blank?

12 A. I believe the surcharge rate per kilowatt
13 hour based on the proposal, the proposed uniform
14 percentage methodology by the company, would be
15 approximately five cents per kilowatt hour.

16 Q. Thank you. And as you show here, the company
17 proposal is to raise all rates by 36.9%, correct?

18 A. Yes, that's correct.

19 Q. And if you go to your Exhibit 1, which is
20 Exhibit 301 in this case, column two of that exhibit, do
21 you have that?

22 A. Yes, I do.

23 Q. Column two of that exhibit is a class by
24 class revenue amount. This is the same number shown on
25 the ICNU cross exhibit. That's correct, right?

00461

1 A. Yes, that's correct.

2 Q. Is this number in column two the total of all
3 rate elements including the customer charge, demand
4 charge, if any, and the energy charges?

5 A. Yes.

6 Q. And it's this total that you have multiplied
7 by 36.9%?

8 A. Yes, that's correct.

9 Q. So the base of revenues you're using includes
10 both the power supply portion of costs and the
11 distribution portion of costs, doesn't it?

12 A. That's correct.

13 Q. And you were here for Mr. Ely's testimony,
14 were you not?

15 A. Yes, I was.

16 Q. And he testified that the reason for this
17 increase that Avista is requesting is higher power
18 supply costs and not higher distribution costs, did he
19 not?

20 A. Yes, he did.

21 Q. I would like to talk about the issue in
22 particular because of the impact it has on two customer
23 classes, the small commercial class, that's Schedule 11,
24 and the street lighting customers in Schedules 41
25 through 49. And just for a moment just for the

00462

1 information of participants here, let's just go down
2 column one and just identify who these different
3 schedules are. Schedule 1 is residential.

4 A. That's correct.

5 Q. Schedule 11 is small commercial.

6 A. Correct.

7 Q. And 21 is large commercial.

8 A. Yes, and small industrial.

9 Q. Small industrial. And Schedule 25 is large
10 industrial.

11 A. Large commercial as well as large industrial.
12 We do serve several actually universities on Schedule 25
13 as well as a couple of large city accounts, City of
14 Spokane, so it's a combination of large industrial,
15 commercial, and institutional customers.

16 Q. Okay. But basically very large customers?

17 A. Yes, that's correct.

18 Q. And then Schedule 31 is pumping?

19 A. Yes.

20 Q. And then the Schedule 41 through 49 are
21 various kinds of street lighting and area lighting
22 schedules?

23 A. Yes, that's correct.

24 Q. Now the small commercial class, Schedule 11,
25 has the highest overall rates of any customer class,

00463

1 correct?

2 A. That's correct.

3 Q. And the street lighting customers have not
4 only power supply and distribution costs in their rates,
5 but also the cost of poles, luminaires, and luminaire
6 maintenance; is that correct?

7 A. Generally that's correct. We offer three
8 different types of street lighting service, where the
9 company owns the facilities and the customer pays
10 basically a capital recovery factor or a lease payment
11 for those facilities as well as the cost of specifically
12 maintaining street lights, so we have three different
13 categories. One is energy only. Two is energy and
14 maintenance, company maintenance performed on those
15 lights. And the third is the customer paying for the
16 cost of the pole and the luminaire as well as
17 maintenance and energy.

18 Q. Okay. Can you just briefly explain what a
19 luminaire is for the record.

20 A. It's basically the lamp, the light.

21 Q. All right. On the last two categories that
22 you mention, the customers have additional costs besides
23 utility costs included in their rates?

24 A. Besides power costs?

25 Q. And distribution.

00464

1 A. Yes, yes.

2 Q. And again, looking back at page 1 of your
3 Exhibit 1, Exhibit 301, the surcharge per kilowatt hour
4 for the Schedule 11 customers is about twice the size of
5 the surcharge for Schedule 25 customers, correct?

6 A. Yes, that would be the effect of a uniform
7 percentage increase.

8 Q. And that's shown in schedule, excuse me,
9 column seven of the exhibit?

10 A. Yes, that's correct.

11 Q. And that's primarily because of the higher
12 distribution costs embedded in the Schedule 11 rates; is
13 that right?

14 A. Well, it's a combination. The overall rates
15 for Schedule 11 are the highest rates of any class we
16 serve, and part of it is due to higher distribution
17 costs and the allocation of power costs as well.

18 Q. All right. As between those two components,
19 isn't it fair to say it's mostly the higher distribution
20 costs?

21 A. I would say generally speaking, yes, although
22 their -- because of their load factor, they do get a
23 higher allocation of power cost as well. I don't have a
24 cost of service study in front of me, so I can't answer
25 that question affirmatively, but it's a combination of

00465

1 those two factors.

2 Q. So you have now -- you have indicated in
3 filling in the blank that the approximate surcharge rate
4 per kilowatt hour for street lighting is about five
5 cents per kilowatt hour, that's correct?

6 A. That's correct.

7 Q. That's your estimate?

8 A. If the increase is spread only to the
9 kilowatt hours served under that schedule.

10 Q. And that's about four times as big as the
11 Schedule 25 surcharge and about three times as big as
12 the system average surcharge, isn't it?

13 A. On a kilowatt hour basis, yes, but it's the
14 same percentage across all customer schedules.

15 Q. And --

16 A. Based on the revenue collected.

17 Q. I'm sorry?

18 A. Based on the revenue collected.

19 Q. All right. And the principal reason for that
20 is that the street lighting class has the distribution
21 cost plus the cost of the lighting fixtures themselves
22 embedded in rates, and your uniform percentage increase
23 applies to all of those components, not just the power
24 supply component, right?

25 A. Yes, that's correct.

00466

1 Q. Now Avista has a purchased gas adjustment
2 mechanism and has had one for many years, correct?

3 A. Yes.

4 Q. And under that mechanism, you or Avista
5 periodically files for changes to gas rates?

6 A. Yes.

7 Q. And when those changes are submitted, are
8 they typically applied on an energy basis or on a
9 uniform percentage of all rate components including
10 distribution costs?

11 A. They're applied on an energy basis.

12 Q. Do distribution costs embedded in gas rates
13 affect the level of the PGA increase that any customer
14 class gets?

15 A. No.

16 Q. So this proposal in this docket is quite a
17 different approach to collecting high power supply costs
18 than you use in the gas context?

19 A. It is a different approach, and there's
20 really two reasons for that. One is the expedited basis
21 on which the company proposes to implement the
22 surcharge, and the second reason is because of the
23 magnitude. I would not argue that from a cost causation
24 standpoint, a uniform cents per kilowatt hour would be a
25 more appropriate way to apply the surcharge. But

00467

1 because of the other two factors that I mentioned, the
2 company chose to perform a uniform percentage basis to
3 all customer schedules.

4 Q. But you say this is more expedited than your
5 PGAs are usually?

6 A. I didn't say it was more expedited. I said
7 because of the expedited nature that the company is
8 proposing to implement the surcharge.

9 Q. Well, I guess turning to other comparisons,
10 are you generally familiar with Puget's ECAC or energy
11 cost adjustment clause?

12 A. Yes.

13 Q. When that was in effect, it's not in effect
14 now?

15 A. Right.

16 Q. When it was in effect, and that was collected
17 on a cents per kilowatt hour also, wasn't it?

18 A. I believe it was.

19 Q. And are you generally familiar with Puget's
20 PRAM or periodic rate adjustment mechanism when that was
21 in effect?

22 A. Yes.

23 Q. Would you agree that that had both a base
24 cost and an energy cost component?

25 A. Yes, I would.

00468

1 Q. And would you agree that the changes in power
2 supply costs were recovered by a uniform percentage
3 adjustment to the energy cost component of rates for
4 each class in the case of the PRAM?

5 A. To my knowledge, yes.

6 Q. So that distribution costs in that program
7 did not affect the level of surcharge when power supply
8 costs increased?

9 A. That's my understanding.

10 Q. And perhaps Mr. Trotter already asked you
11 this question, but can you point to any power supply
12 surcharge approved by this Commission which was applied
13 to the sum of both power supply and distribution costs?

14 A. Not to my knowledge, I don't know of any.

15 Q. How about any gas supply cost surcharge?

16 A. Not to my knowledge.

17 Q. In a general rate case, these higher power
18 supply costs would be a component of the cost of service
19 prepared by the company, wouldn't they?

20 A. Yes, they would.

21 Q. Would you agree that these would normally be
22 allocated among the customer classes on the basis of
23 their respective demand and energy allocation factors?

24 A. Yes, they would in a cost of service study,
25 but that wouldn't be the sole factor that the Commission

00469

1 would consider in setting rates. They would consider
2 other factors as well.

3 Q. And would you further agree that in such a
4 cost of service study, the spread of these costs would
5 be such that the small general service customers and the
6 street lighting customers would be assigned a
7 significantly smaller share of these costs than the
8 uniform percentage surcharge method you have proposed?

9 A. I would generally agree with that.

10 Q. Let's finish up with one or two other topics.
11 You have been with the company a long time, correct?

12 A. I have.

13 Q. As far as you know, has Avista or Washington
14 Water Power ever performed studies or analyses of the
15 economic impact of its rates on its customers or service
16 territory?

17 A. I guess it depends what you mean by studies.

18 Q. Any kind of review or analysis of any type.

19 A. We have done -- looked at the effects of
20 consumption or electric energy consumption over time and
21 tried to correlate that consumption to changes in
22 prices, among other factors. As far as formal studies
23 submitted to this Commission, I can't think of any off
24 hand. But again, we have done -- looked at consumption
25 by class and how it changes over time.

00470

1 Q. Has Avista ever had a rate increase this
2 large in the time that you have been with the company?

3 A. I can't recall one this large, but that
4 doesn't mean we haven't. I can't recall one this large.

5 Q. All right. Can you remember the next largest
6 one to this?

7 A. No, I can't.

8 Q. As far as you know, has the company ever
9 requested a one time rate increase of this size in the
10 company history?

11 A. Not to my recollection, but I recall some
12 fairly significant increase proposals I believe in the
13 early '80's.

14 Q. But then, of course, those would have been on
15 a smaller base at that time?

16 A. That's correct.

17 Q. The -- so I take it -- well, let me ask going
18 back to sort of the question of studies or analysis.
19 Has the company done any study or analysis or review of
20 the impact of a rate increase of this magnitude on its
21 customers, on its service territory, on the communities
22 that it serves?

23 A. Not a specific analytical analysis.
24 Certainly we talk to customers in all -- that are served
25 under all classes, all various schedules. But in terms

00471

1 of an analytical study, I don't believe so, other than
2 the price elasticity estimates that go into our load
3 forecast.

4 Q. Are those analyses that you described reduced
5 to writing?

6 A. I'm sure there's some narrative supporting
7 the numbers that go into our load forecasts, yes.

8 Q. Does the analysis that you're referring to
9 measure the impact on employment, on industrial
10 development, on an economic development in the
11 communities that Avista serves?

12 A. Certainly we look at those factors in
13 developing our load forecast.

14 Does that address your question?

15 Q. Well, I'm trying to determine if the company
16 has looked at those questions with respect to this rate
17 increase.

18 A. Yes, yes, we have. This proposed rate
19 increase has been considered in developing next year's
20 load forecast for 2002.

21 Q. Can you relate the results of the analysis
22 that the company has performed in terms of the factors I
23 mentioned or other factors that the company looked at?

24 A. I think the specific what would result in
25 numerical estimates that would go in the load forecast

00472

1 would relate to price elasticity, basically changing
2 consumption as rates change. So there is -- there is a
3 I will call it a price elasticity factor that's used in
4 the load forecast that would relate to any proposed or
5 anticipated change in rates that would affect our load.

6 JUDGE MOSS: Mr. ffitch, how much more?

7 MR. FFITCH: I'm just about finished, Your
8 Honor. I'm just trying to determine if I have any
9 additional questions.

10 BY MR. FFITCH:

11 Q. Have you performed as part of this analysis
12 or any other analysis a determination of how many people
13 would be unemployed or would lose their jobs in your
14 service territory as a result of this rate increase?

15 A. No, but that's certainly a concern of ours,
16 of the company's.

17 MR. FFITCH: I don't have any further
18 questions. Thank you, Your Honor.

19 JUDGE MOSS: Thank you. I wonder if we
20 should take our morning recess before we have questions
21 from the Bench. I see some nods of affirmation.

22 CHAIRWOMAN SHOWALTER: Well, I have a ten
23 second question.

24 JUDGE MOSS: Ten second question, so let's go
25 forward.

00473

1

2

E X A M I N A T I O N

3

BY CHAIRWOMAN SHOWALTER:

4

Q. This is just to repeat the question which you partially answered in talking to Mr. ffitich. But who are the institutional customers? What are they generally, and who are they in particular?

8

A. We serve three, two universities and one college, under Schedule 25, our largest rate schedule.

10

Q. So there are three institutional customers?

11

A. Yes.

12

Q. And then where, for example, are hospitals; what schedule are they on?

14

A. Actually, we serve two, the two largest hospitals in Spokane under Schedule 25 as well.

16

Q. So five institutional?

17

A. Five institutional, yeah. Thank you for correcting me.

19

Q. And that would be -- would that be Gonzega and Eastern Washington University?

21

A. Actually, Gonzega, Washington State University, and Spokane Community College.

23

Q. And the two hospitals?

24

A. Sacred Heart and Deaconess.

25

CHAIRWOMAN SHOWALTER: Thank you.

00474

1 JUDGE MOSS: No redirect?

2 MR. MEYER: No redirect.

3 JUDGE MOSS: All right.

4 MR. VAN CLEVE: Your Honor, could I ask one
5 follow-up question briefly.

6 JUDGE MOSS: All right.

7

8 R E C R O S S - E X A M I N A T I O N

9 BY MR. VAN CLEVE:

10 Q. Mr. Hirschhorn, did the company communicate
11 after it entered into the settlement last spring with
12 customers that it was pursuing a plan to avoid any rate
13 increases related to power cost increases?

14 MR. MEYER: You know, I don't see how this is
15 a follow up to anything that's gone before.

16 JUDGE MOSS: I don't either, Mr. Van Cleve.

17 MR. VAN CLEVE: Well, Your Honor, I think
18 that we have had a lot of discussion about potential
19 impact on customers, and I think whether they expected
20 no increase and are now facing potentially a 55% rate
21 increase is relevant.

22 JUDGE MOSS: Well, I think I will sustain the
23 objection. We don't need to go there.

24 All right, I want to take our break. I think
25 we can release Mr. Hirschhorn from the stand for the

00475

1 time being, and thank you very much for your testimony.
2 We will take our morning recess until 11:00,
3 and then we will return, and I believe after that we
4 will have Mr. Schoenbeck on the stand.

5 (Recess taken.)
6

7 (The following exhibits were identified in
8 conjunction with the testimony of DONALD W. SCHOENBECK.)
9 Exhibit 651-T is Pre-filed Direct Testimony.
10 Exhibit 652 is DWS-2 Qualifications and Background.
11 Exhibit 653 is DWS-3 Deferral Value Schedules.

12

13 Whereupon,

14 DONALD W. SCHOENBECK,
15 having been first duly sworn, was called as a witness
16 herein and was examined and testified as follows:

17

18 D I R E C T E X A M I N A T I O N

19 BY MR. VAN CLEVE:

20 Q. Could you please state your name for the
21 record.

22 A. My name is Donald W. Schoenbeck, that's
23 S-C-H-O-E-N-B-E-C-K.

24 Q. Are you appearing in this proceeding on
25 behalf of the Industrial Customers of Northwest

00476

1 Utilities?

2 A. Yes, I am.

3 Q. And have you prepared direct testimony which
4 has been identified as Exhibit 651-T?

5 A. Yes, I did.

6 Q. Have you also prepared two exhibits to your
7 direct testimony which have been identified as Exhibits
8 652 and 653?

9 A. Yes, I did.

10 Q. Do you have any corrections or additions to
11 your direct testimony?

12 A. Yes, I have three modifications beginning on
13 page six of 651-T.

14 Q. Can you tell us what the first change is?

15 A. At line 24 on page 6, change the date May 4
16 to April 16th. The second change is at the top of page
17 7 after the first word there, normal, period, insert the
18 new sentence, this was at least one week before the
19 first all party settlement meeting which led to the
20 filing of the stipulation, period.

21 JUDGE MOSS: I'm going to ask you to repeat
22 that, Mr. Schoenbeck.

23 THE WITNESS: Sure. This was at least one
24 week before the first all party settlement meeting which
25 led to the filing of the stipulation.

00477

1 BY MR. VAN CLEVE:

2 Q. And what's the final change that you have to
3 your testimony?

4 A. The final change is at page 8, line 14. It's
5 another additional sentence. It should read:

6 Indeed, this is the case for the months
7 of August, September, October and
8 November as well.

9 Those are all the modifications to the
10 testimony.

11 COMMISSIONER HEMSTAD: Could you repeat that
12 once more, sir.

13 THE WITNESS: Certainly. The sentence would
14 read, indeed, this is the case for the months of August,
15 September, October, and November as well.

16 BY MR. VAN CLEVE:

17 Q. Mr. Schoenbeck, with these modifications, if
18 I were to ask you the questions that are contained in
19 your direct testimony, would your answers be the same
20 here today?

21 A. Yes, they would.

22 MR. VAN CLEVE: Your Honor, I would offer
23 Exhibit 651-T, 652, and 653, and Mr. Schoenbeck is
24 available for cross-examination.

25 JUDGE MOSS: There being no objection, those

00478

1 exhibits will be admitted as marked.

2 Mr. Meyer.

3 MR. MEYER: Thank you, Your Honor.

4

5 C R O S S - E X A M I N A T I O N

6 BY MR. MEYER:

7 Q. Good morning, Mr. Schoenbeck.

8 A. Good morning, Mr. Meyer.

9 Q. Is it your recommendation on behalf of ICNU
10 for an 11.9% surcharge spread out over a 15 month
11 period?

12 A. Yes, it is. And again, it's for the -- it's
13 a place holder amount for the costs that were deferred
14 for the months of July through June of this year.

15 Q. So it is based in part, your recommendation
16 that is, on a proposal to only reflect or recover
17 through this part of the surcharge costs incurred prior
18 to June of this year?

19 A. Yes. Just to amplify again, under the
20 proposal, you would do a place holder surcharge for
21 those months, and then you would continue to defer under
22 the existing accounting procedures all subsequent
23 deferrals. So it's not a cessation of the deferral
24 mechanism. It's simply addressing what would likely be
25 recovered from a reasonableness review of the actual

00479

1 cost. In doing so, it sidesteps the more authority
2 issue of looking at what, if any, surcharge should be
3 recovered from customers now for costs as of the 1st of
4 July.

5 Q. So you take issue with what I understand to
6 be one of Staff's recommendations, which is to suspend
7 the deferral mechanism after June of this year, correct?

8 A. Well, I don't know if I would say I take
9 issue with it. I just said that under our proposal, it
10 would continue.

11 Q. Okay. Now, Mr. Schoenbeck, having described
12 at least generally the thrust of your proposal, where
13 have you examined in your testimony or your exhibit
14 material the impact of your proposal on the company's
15 ability to meet its fixed charge ratios under its
16 covenants?

17 A. I did not undertake that analysis. There was
18 simply not enough time, and it did not fall under my
19 responsibility in this docket.

20 Q. Mr. Schoenbeck, where, if at all, in your
21 testimony or exhibits have you examined the ability of
22 the company to meet its covenants were your
23 recommendation excepted?

24 A. I did not do that analysis. My analysis was
25 looking at the costs that have been deferred for the

00480

1 historical period, what would likely be allowed after a
2 prudency review.

3 Q. Mr. Schoenbeck, where, if at all, in your
4 testimony and accompanying exhibits have you analyzed
5 the impact of your proposal on the company's ability to
6 issue new equity financing?

7 A. That's basically the same answer I just gave.

8 Q. Where, if at all, Mr. Schoenbeck, in your
9 testimony or exhibits have you examined the impact of
10 your recommendation on the company's ability to finance
11 Coyote Springs II?

12 A. Again, it's the same recommendation. I did
13 not look at the nor did I calculate any sort of
14 financial or coverage ratio based upon the 12% increase
15 I'm recommending.

16 Q. Finally, Mr. Schoenbeck, where, if at all, in
17 your testimony or your exhibits have you examined the
18 impact of what you recommend were it adopted by this
19 Commission on the company's credit ratings?

20 A. Again, I did not undertake that analysis.
21 The analysis was of the costs that the company incurred
22 during this remarkable or extraordinary market period,
23 should they get recovery of. And obviously the proposal
24 is \$83 Million, so it's a substantial sum that we're
25 using as a place holder at this time.

00481

1 MR. MEYER: Thank you, I have no further
2 cross.

3 JUDGE MOSS: Staff?

4 MR. TROTTER: No questions.

5 JUDGE MOSS: Public Counsel.

6 MR. FFITCH: Just a couple of brief
7 questions, Your Honor.

8

9 C R O S S - E X A M I N A T I O N

10 BY MR. FFITCH:

11 Q. Mr. Schoenbeck, pages 12 to 14 of your
12 testimony, Exhibit 651-T, you propose that a portion of
13 the deferrals through June 30th be assigned to the
14 company and not rate payers based on the dry year 1988
15 and the water study used to set rates in the last rate
16 case, correct?

17 A. That's correct.

18 Q. And that amount is \$25.6 Million?

19 A. Yes, it is. It's shown in the final entry in
20 the bottom right-hand corner of that table on page 13.

21 Q. And the rest of the deferrals through June
22 30th you propose to include in a surcharge which you
23 calculate at 11.9% for 15 months?

24 A. Yes, the entire amount is approximately \$83
25 Million, and I am employing the company's two step

00482

1 approach of first using the PGE amortization to offset
2 that amount and then recover the rest using the
3 identical time period that the company is proposing for
4 the accelerated amortization of 15 months.

5 Q. That seems to do two things, as I understand
6 it. First, using the dry year as a basis seems to be
7 based on a theory that the company has already been
8 compensated for that level of risk; is that right?

9 A. Well, it's the implicit recognition or
10 explicit recognition that when you set rates based on
11 the water conditions that you can get power costs above
12 or below the expected value. That is just the normal
13 standard rate making. So implicit in the rate making
14 process is the fact that the conditions will -- could be
15 better or could be worse. Certainly if conditions had
16 been much better, would not -- I would not expect the
17 company to come forward offering to refund the moneys,
18 nor do I expect the customers to be held responsible for
19 all the excess power costs above the average value that
20 was established in rates.

21 Q. The second thing that seems to be going on
22 with your recommendation is that you base a surcharge on
23 100% of the remainder of the amount left, and that seems
24 to imply that these should be recoverable from rate
25 payers. And I guess my question is, I want to clarify

00483

1 your testimony, are you suggesting that conclusion, or
2 are you, I think I heard you already in your testimony
3 today say that the prudence question is still
4 outstanding?

5 A. Yes, I have always termed it a place holder
6 amount, because I think the company still has to offer
7 the evidence on why all the costs during this historical
8 period were prudent. There is simply not enough time
9 given the accelerated scheduling of this proceeding to
10 do an in-depth review, though I noted in my testimony I
11 am relatively comfortable with the historical purchase
12 power costs that were made by the company for this
13 period.

14 The fundamental problem I have is once you
15 start going beyond the July 1st date, you're now looking
16 at a true prudency question on some of the purchase
17 power contracts that were entered into by the company
18 for the months of the second and third quarter, third
19 and fourth quarters of this year, coupled with also the
20 questionable hydro assumptions and the resulting hydro
21 forecast.

22 So by focusing, I thought the appropriate
23 thing to do was focus on the historical costs that were
24 incurred, look at what you would expect to come out of a
25 reasonableness review, offset that amount by the PGE

00484

1 amortization, and then recover the rest through a
2 surcharge. So that's my proposal.

3 Q. Thank you. Just one other matter, you were
4 not here yesterday, and I thought I heard the company
5 testify that Boulder Park, excuse me, Boulder Peak
6 capital O&M expenses were not included in the deferral.
7 If I can get you to turn to DWS-3, which is Exhibit 653.

8 A. Do you have a particular schedule in mind?

9 Q. Schedule 1, line three, that shows that \$9.7
10 Million of those costs are included. Am I reading that
11 correctly?

12 A. Yes, you are.

13 Q. What was the source of that figure?

14 A. Well, I tried to put that down in the
15 footnote, so that would have been power supply workpaper
16 14 and 15 is where I drew those numbers from.

17 MR. FFITCH: Thank you, Your Honor, no
18 further questions.

19 JUDGE MOSS: From the Bench?

20

21 E X A M I N A T I O N

22 BY CHAIRWOMAN SHOWALTER:

23 Q. Mr. Schoenbeck, you said that you were not
24 retained to analyze the effect of your proposal or
25 another, any other proposal, on the status of a number

00485

1 of elements that Mr. Meyer outlined, those being the
2 fixed charge ratio, the ability of the company to meet
3 its covenants, to issue equity, to continue the Coyote
4 Springs, and the effect on the company's credit ratings.
5 Do you agree though that this Commission should look at
6 those factors when it decides what to do?

7 A. Well, certainly commissions have historically
8 looked at factors such as those as long as they were
9 related to the utility operations. Maybe the best way
10 to describe it is by way of an example. If you go back
11 to the 1970's when Commonwealth Edison was building a
12 whole series of nuclear plants, they were allowed
13 construction work in progress solely to allow the
14 company to maintain adequate coverage ratios and cash to
15 fund those projects plus maintain their certain bond
16 rating. But that was specifically with respect to the
17 activity of the electric utility.

18 What has to be examined in the case of Avista
19 is, in my mind, the exact same question. How has the
20 activity of the electric utility affected its bond
21 rating, its cash flow, its coverage ratios. To the
22 extent investments in non-regulated subsidiaries had
23 impact on the overall corporate ratings, I don't believe
24 that should be considered by you in determining the
25 level of rate relief they should be granted.

00486

1 Q. But let's assume for the sake of argument
2 that the only reason that the company's -- that these
3 five elements are in jeopardy is due to unregulated
4 activities, but then isn't it nevertheless if the
5 company is in those circumstances, doesn't that affect
6 and jeopardize the regulated activities and the rate
7 payers? And that's I put it the example, the
8 hypothetical, very extremely.

9 A. Sure.

10 Q. I don't really believe that that is the case,
11 but what I'm trying to get to is, aren't we -- isn't the
12 company saying that if it doesn't get some kind of
13 relief soon in essence to satisfy its bankers and Wall
14 Street, however it got into this situation or whatever
15 environment occurred to it, that the utility is in
16 jeopardy?

17 A. I don't believe so actually.

18 Q. Okay. You don't believe the company is
19 saying that, or you don't believe that's the case?

20 A. I'm addressing your hypothetical. Your
21 hypothetical were to the extent the -- all the problems
22 were created by non-regulated affiliates, I believe you
23 as a Commission can still recognize and impute a cost
24 for a minus Triple B plus credit rating for the electric
25 side of the house.

00487

1 Q. Okay. Supposing we did that and supposing
2 that's all we did, or maybe we adopt the Staff's
3 recommendation, but supposing the result is Moody's and
4 others downgrade the credit rating to below investment
5 grade?

6 A. Mm-hm.

7 Q. We can't order that otherwise, so we're
8 dealing with a larger environment here.

9 A. Right.

10 Q. If that happened, then what is the effect on
11 the rate payers in the regulated utility?

12 A. Maybe a more current example is looking at
13 the rate payer effects so far on utilities such as
14 Pacific Gas and Electric, who is obviously in bankruptcy
15 proceedings. The effect on the rate payer, per se, has
16 been unnoticeable to date. What has happened, of
17 course, is obviously suppliers of that utility are going
18 unpaid, are receiving only partial payments. But with
19 respect to the rate payers, with respect to the
20 regulated action of that California Commission, nothing
21 is -- nothing was done to prevent PGE from entering into
22 bankruptcy under the rate compact they had entered into.

23 Q. So are you sanguine about the prospect of
24 Avista being unable to pay its bills?

25 A. No, not at all, not at all. And again, you

00488

1 know, I believe our proposal at \$83 Million is a
2 substantial sum. I think that is a substantial sum of
3 money, and the 12% is a significant increase, so that
4 isn't in my view recognition of the extraordinary
5 circumstances the company went through on a historical
6 basis.

7 Once you obviously start forecasting and
8 looking into a crystal ball and saying, well, will we
9 get below average precipitation in the months of
10 October, November, and December like the company assumed
11 in their current forecast, that starts getting much
12 dicier. When the company -- because as we well found
13 out from the PSE proceeding, you simply do not know what
14 rain will come or rain will fall or snow will melt in
15 the months ahead.

16 And that's why I think certainly the company
17 should be given some amount of relief for what they went
18 through this past year. They obviously have some of the
19 lowest rates in the nation, have done a good job to
20 date. But to focus where I'm in disagreement with you
21 is the focus in my mind should still stay within the
22 electric utility operations with respect to their
23 regaining their financial health.

24 Q. Well, if we focused only on the utility side
25 and whatever we did were sufficient to protect the rate

00489

1 payers, we wouldn't -- there's really not an issue. But
2 if we stay -- if we keep our analysis to the utilities
3 side, and as a result of that analysis, whatever we do
4 is not enough, then don't we get put in this position of
5 saying, well, you know, this wasn't our problem, and it
6 was somebody else's, some other side of the business
7 caused this, and so we only give X amount of relief, and
8 if it doesn't, in fact, satisfy the bankers, at that
9 point, you say, well, then that's life?

10 A. You have the situation similar to PG&E.

11 Q. Well, that's why I asked if you were sanguine
12 about that situation?

13 A. And I said no, but at some point in time, you
14 have to have accountability and responsibility. And the
15 electric rate payers of this utility should not be held
16 accountable or responsible for moneys associated with
17 unregulated activity that they don't receive the benefit
18 from.

19 Q. Now the questions we just had all were on a
20 hypothetical assumption that the problem was caused.

21 A. Mm-hm.

22 Q. Now there has been a fair amount of evidence
23 I think the other way, that is that it is not the
24 non-regulated activities, it was either regulated or
25 weather and other things.

00490

1 A. It's probably a combination of many things.

2 Q. Right. I wanted to ask about your proposal
3 that we track or allow recovery only of the actual costs
4 incurred through June of this year.

5 A. Through the end of June.

6 Q. End of June of this year. If whatever we do
7 is subject to refund based on a review of not just
8 prudence but other issues, will it or won't it end up
9 being actual cost? In other words, if we authorize some
10 percent, let's say we authorize the company's proposal,
11 and so there is a 36% surcharge for X months, won't we
12 be looking at that -- at those moneys again at a later
13 period in time, and if they weren't actually spent for
14 what was needed, wouldn't that be part of a refund
15 analysis?

16 A. Sure, but there's also a substantial customer
17 factor. You're talking in terms of roughing the company
18 and the regulator, it's kind of status quo. But for the
19 customers that undergo these enormous rate increases,
20 it's real money, it's real operations that they have to
21 decide the next day.

22 When the California Public Utility Commission
23 put in their recent 3 cent surcharge increase and they
24 did not spread it across all customer classes so some of
25 the industrial classes saw as much as an 80% to 100%

00491

1 increase, what you immediately saw happening was the
2 utilities saying, we're not going to collect enough
3 money, because the industries shut down.

4 So in my mind, instead of looking at the
5 company's proposal and saying well, we will give them
6 37% right now because at some point in time the
7 customers will be made whole, that's not really the
8 case, because there are real operations involved, real
9 business decisions being made that will have
10 repercussions on the end use customers. So it's not
11 just a cash flow issue between the company and these
12 customers, it's a real decision making point.

13 Q. Well, then that brings it back to the
14 exercise of trying to base a surcharge or some kind of
15 rate increase on some type of probability of recovery.

16 A. Right.

17 Q. Now we have had a lot of discussion about the
18 lack of a presumption of recoverability, but doesn't it
19 cut both ways? That is, what you are saying is if we
20 authorize too large of an increase that later turns out
21 needs to be refunded, that the customers who have to pay
22 it up front are -- will be harmed. They may get it with
23 interest, but they would be fronting this amount of
24 money that on later analysis turns out to be too much?

25 A. And a customer may cease operating.

00492

1 Q. Right.

2 A. So what are you going to refund to him?

3 Q. But aren't we to some extent, isn't there the
4 opposite phenomenon as well?

5 A. Sure.

6 Q. And it happens with PGAs as well, that nobody
7 wants to pay the money now, but if you don't pay it now,
8 you get a big buildup in a PGA or a deferral or some
9 other thing. And then comes time to pay the bill, and
10 it's rate shock then. So doesn't that put us in the
11 position of more or less estimating what seems
12 reasonable, and there's a range to reasonable, but
13 within some kind of range of probable recoverability, we
14 don't want to go too high, we don't want to go too low,
15 because if you go too low, you're going to have to pay
16 the piper later, if you go too high, you shouldn't have
17 paid it to begin with?

18 A. Right.

19 Q. So maybe this gets back to that question,
20 whether given the company's proposal, do you think it's
21 in that range or not?

22 A. No, I definitely do not. Because remember,
23 under the company's proposal, they're seeking every
24 dollar that they have deferred, and they're seeking
25 substantial dollars on projections and contracts that

00493

1 based on my review to date are very un -- I would say
2 there would be a very unlikely probability they would
3 get 100% of the bills recovered.

4 That's why under my approach, I'm saying,
5 okay, come up with a place holder, an amount that
6 probably has an extraordinarily high probability
7 associated with it given the prices, given the market,
8 you know, I don't want to put a probability higher than
9 95%, but it's in that type of a probability for the \$83
10 Million I'm willing to give. Under a reasonableness
11 review, I think there would be that high of a
12 probability that they would get that amount of money.

13 Q. All right.

14 A. Everything beyond that I believe is highly
15 suspect.

16 Q. All right. So you have gone through your
17 exercise of a judgment of what would likely be
18 recoverable, and the company and Deloitte & Touche have
19 gone through their exercise, and in essence both of you
20 are saying, I think this is an amount that ultimately
21 would be recoverable. Your amount is lower than their
22 amount.

23 A. My amount is about 80%, 80% of the amount
24 they have historically booked. But again, the critical
25 part of my proposal is we will continue to defer

00494

1 subsequent months' costs, July, August, September, going
2 forward, we will continue to defer those, so there would
3 still be a chance for another surcharge associated with
4 those moneys as well.

5 Q. Mm-hm.

6 A. So it changes the proposal from 37% based on
7 suspect forecasts, every power contract I entered into
8 in the months of May and June, all my forecasts of all
9 my capital additions through the year 2003. In my mind,
10 all the capital additions, if the company does come
11 forward with a rate case in November, all the capital
12 additions could still be put in rates on a permanent
13 basis as of that date, you know, basically by the time
14 my 15 month period amortization surcharge ceases. So
15 they can have all of their capital additions, but they
16 would undergo what I'm saying is the normal rate making
17 process where you do it in the context of a general rate
18 case.

19 So the only thing it leaves open then in that
20 would be the potential for an additional surcharge,
21 would be associated in my mind that the cost from the
22 July period up until the time that general rate case
23 rate relief could start, in other words, a change in the
24 base rates. So that would be kind of the middle period
25 of time that they would still be booking all of those

00495

1 costs to the deferred account.

2 Q. If you take Coyote Springs, supposing it is a
3 good idea that it be built and retained for Avista's
4 rate payers, and that may be a debatable point depending
5 on a number of factors, but isn't -- wouldn't it
6 normally be that the company has decided it's a good
7 idea, it proceeds to finance, it can get the money, it
8 knows that later it can come back to the Commission,
9 come to the Commission and justify its expenses, and it
10 makes a judgment that it probably can, and so it goes
11 ahead, and it gets built into a rate case.

12 A. Mm-hm.

13 Q. But in this situation, at least what we're
14 hearing is that they really can't do that because they
15 can't get the financing.

16 A. Yeah, it's the Commonwealth Edison problem.

17 Q. Yeah. So what I hear you saying is that if
18 your proposal doesn't happen to be good enough to
19 satisfy the bankers for whatever reason, and one of the
20 consequences of that is they can't get financing for
21 Coyote II, well, then so be it, or give me another
22 analysis.

23 A. No, but that is basically the harsh reality.
24 But one question you as a regulator would have to ask
25 is, how could this same corporate entity build a

00496

1 merchant plant without a problem, and now when it comes
2 to funding a very similar type of plant for their
3 electric operations, now they can not. From my mind,
4 that's one of the questions that you as a regulator
5 would want a good solid answer to.

6 To the extent there was a significant amount
7 of funds generated from that monetization of the PGE
8 agreement, where did those dollars go. If those dollars
9 went to build Rathdrum, couldn't they just as easily
10 have been color coded for Coyote Springs, giving their
11 unaffiliated or unregulated affiliate the problem with
12 financing a new plant. Those are the types of questions
13 that should be looked at in doing a prudency review.

14 Q. Well, let's -- and let's say we do look at
15 those questions in the prudency review, in other words
16 we've got, you know, 11 months from the date of filing
17 to look at those questions, but supposing we find they
18 should have applied the money to Coyote Springs instead,
19 but they didn't, and so then what?

20 A. So it's their shareholders, it's their
21 shareholders, it's not the rate payers. And that's what
22 I see occurring if you would give them their 37%
23 deferral for the entire time period. It's basically a
24 bail out of the entire corporation, and that's why I
25 think again the focus should be on the electric side. I

00497

1 tried to look at what costs did the electric side incur
2 during this period and say what amount should be born by
3 rate payers. That's a sizable amount of money.

4 Q. So the line that you are drawing is that if
5 it amounts to a bail out by the rate payers of the
6 shareholders, that's where you draw the line and let the
7 company collapse if that's what happens?

8 A. If that's what happens -- well, put another
9 way, what has the company offered with respect to
10 shareholder dollars in this proposal? It's not a dime.

11 Q. But isn't that kind of a vicious cycle as
12 well that we have had some discussion of, that in order
13 to put up shareholder dollars, there have to be
14 shareholders, and there has to be stock, and all of
15 those issues?

16 A. But at some point in time, and that's -- I
17 guess that's what the prudency review is all about.
18 It's where the action is without using 20/20 hindsight,
19 but the facts that were known at the time, were the
20 actions undertaken by the utility appropriate?

21 Q. Another question I have is of timing. The
22 company today seems to be facing difficulty, and it's in
23 a difficult environment, and we don't know whether the
24 -- at least I don't know whether various expenses were
25 prudent or not. In other words, I'm not going to make

00498

1 the presumption that they were, but I'm also not going
2 to make the presumption that they weren't.

3 A. Mm-hm.

4 Q. And I think maybe you do, well, you do have a
5 more critical judgment about it than I do. So there's
6 much we don't know today. Now if we authorized an
7 increase today subject to later prudency review, isn't
8 there the possibility anyway that the company and its
9 shareholders would be in better circumstances in order
10 to take a hit if that's what it comes to, because the
11 environment may change? In other words, it's pretty bad
12 today, so that that balancing of shareholder risk and
13 rate payer risk might be able to be made appropriately
14 at a later point, both because we the Commission would
15 have more information, and because there may be the
16 ability to absorb it. Whereas if today if we withhold
17 the increase now because we can't justify it based on
18 guesses of prudency, there may not be shareholders or a
19 company to take part of the blame, if you will.

20 A. Well, there may not be this company or these
21 shareholders to take the blame for that, but that's
22 another story. I don't strongly disagree with anything
23 you said, but I still think you're missing the critical
24 element of the customer impact, the customer impact of
25 getting a potential 37% or 55% increase, and his

00499

1 subsequent actions may not be recoverable. If a
2 business shuts down for a period of time, it's real loss
3 of jobs, real loss in the income for that company
4 possibly because of the electric increase. How can that
5 be recovered?

6 That's why I think you've kind of hit the
7 nail on the head, you're in a very uncomfortable seat
8 where there's this tension between giving the company
9 37% and saying, can we come back later under prudence
10 review and correct everything. That's why I question
11 that assumption. Is everything correctable, if you
12 will, and I don't believe it is.

13 Q. So we got to balance, I guess, the risk to
14 today's rate payers that these amounts are too high
15 because they're not recoverable with the risk that if we
16 don't allow enough recovery that turns out to be
17 recoverable, number one, we may not have allowed the
18 company to stay in business when it should have been
19 able to, and number two, these would be ultimately
20 recoverable amounts that the rate payer would, in fact,
21 have to pay?

22 A. But remember under my proposal, the only
23 thing I'm saying arguably is not recoverable right now
24 is about the \$26 Million that Mr. ffitich pointed out.
25 So with respect to the company's proposal where they're

00500

1 saying we basically want approximately \$245 Million now
2 through the 36% increase amortized over the 27 months,
3 I'm saying give them \$83 Million now and continue to
4 defer the rest. So I'm not saying -- it could very well
5 be recoverable. I'm not saying those moneys go away.
6 I'm just saying they don't get to charge current rate
7 payers for them today or September 15th.

8 CHAIRWOMAN SHOWALTER: Thank you.

9

10 E X A M I N A T I O N

11 BY COMMISSIONER HEMSTAD:

12 Q. Mr. Schoenbeck, first just to sort of be
13 clear what your position is as a practical reality, I'm
14 looking at the bottom of page one of your testimony at
15 line 21, reading:

16 It is ICNU's position that Avista's
17 request for a surcharge is unjustified
18 and should be not -- denied. However,
19 should the Commission decide a surcharge
20 is warranted, ICNU requested that it
21 determine the maximum level of rate
22 surcharge that the Commission should
23 impose.

24 Do you as an expert have a view as to the
25 first part of that, that, in other words, that is your

00501

1 personal view that there should be no surcharge is
2 justified?

3 A. Well, again, actually I did not look at that
4 question directly at all. What I was looking at was
5 given the elements of what they're seeking to collect,
6 which ones or what amount would fairly likely be
7 recoverable subsequent to a prudency review. So that
8 was really the focus of my analysis. That's why I
9 responded to Mr. Meyer the way I did. I did not look at
10 the company's financial fixed charge ratios or cash flow
11 statements.

12 Q. I'm trying to sort out in my mind at this
13 point the piece parts of the surcharge request of the
14 company and your position on each of them. I'm not
15 suggesting your testimony is not clear. It's my ability
16 to grasp the various elements at this point. Do any of
17 your schedules lay that out in a way that's reasonably
18 understandable?

19 A. What I tried to do in putting these schedules
20 together is from schedule two on Exhibit 653, which was
21 pre-marked as Exhibit DWS-3, I tried to replicate the
22 company's methods, with the difference again being I
23 just limited the analysis to the 12 months of July
24 through June. What I tried to do is in replicating
25 their efforts, any line I inserted I put an A after the

00502

1 corresponding company line number. So on schedule two,
2 for example, where you see line 34-A below line 34,
3 that's a line that was not on the company's comparable
4 either worksheet or exhibit.

5 And that -- so in large part, I have tried to
6 replicate every aspect of the company's calculations
7 with this one singular adjustment with respect to the
8 water and market risk I think should be born or the
9 responsibility to the shareholders. And again, it's
10 about \$26 Million for this company I'm saying arguably
11 should be the responsibility of the shareholders, but
12 yet the rate payers should be willing to pay about \$83
13 Million of the extraordinary expenses that went on at
14 this time. So if you think about it, it's more into a
15 20/80 split between shareholders and rate payers of all
16 the historical cost.

17 And that's really the only difference between
18 what the company did -- or what I attempted to do is
19 mechanically replicate what the company did, just simply
20 cutting off the deferral date as the balance ending June
21 of this year. Then all the subsequent -- and then
22 subsequently I'm saying that the utility can continue to
23 defer all the costs they're doing under your accounting
24 direction on how to defer additional cost, but would
25 just look at a later time, either through a general rate

00503

1 case that looks into the capital additions, or the
2 prudency review that would link in both this first
3 historical period, which is ending June '01, coupled
4 with this second period that would end with the
5 commencement of their base rate change in the general
6 rate case.

7 I'm saying that's -- those are still open
8 issues the company could argue in the prudency review,
9 they want the whole 100% of the dollars. I will
10 continue to argue that, no, they should only get 80% of
11 the dollars. But that was the only change I really
12 tried to make to the company's, or maybe call it two
13 changes. If you call them one change, the market hydro
14 adjustment, then just simply cutting off the deferral
15 period to calculate the surcharge. Those are the only
16 two changes I really made to the company's presentation.

17 Q. Okay. So you would agree with the company,
18 for example, with respect to the monetization of the
19 Rathdrum amortization, what is that worth, \$53 Million?

20 A. The PGE amortization, right, 53.8.

21 Q. And that's just a way to grab on to some
22 money and bring it forward for current use because it's
23 there, I guess. That's a layman's way of evaluating
24 that there's some -- there's a bunch of money there that
25 you can grab on to?

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1 A. That's correct. Obviously it wouldn't be
2 there for the next deferral period. Once that money is
3 gone, it's -- that's it. At the end of December of '02,
4 that amortization would cease, so that would then have
5 to be made up by the surcharge percentage for beyond
6 that period.

7 Q. And the company and you and the Staff all
8 agree with that?

9 A. I don't think Staff agrees with it.

10 Q. Oh.

11 A. I believe the Staff may have taken exception
12 to the accelerated amortization.

13 Q. All right. Then you agree with the company
14 on that?

15 A. I think it makes good sense to minimize the
16 impact.

17 Q. Okay. Then Coyote Springs, normally a
18 company would, under traditional rate making, would
19 proceed to construct its plant and then come in in the
20 future rate case and ask that that asset be placed in
21 rate base and recovered. Well, now what, how would you
22 describe what the company is asking for here?

23 A. Well, it's a fine line. What the company is
24 asking for here in my mind, that gets into the notion of
25 my position that every dollar is not recoverable in

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1 their deferred account. That's why the concern of --
2 and that's why I used the term prepaying for Coyote
3 Springs, because the company's proposal is to basically,
4 the way they came up with the deferral percentage, a
5 significant portion of the deferral in the forecast
6 period is directly associated with Coyote Springs. It's
7 in the neighborhood of, I believe if you look at my
8 Schedule 1, it's -- I think it's \$53 Million or so.
9 It's actually closer to \$59 Million as part of their
10 deferral on a future basis.

11 Now under my proposal, they still can come
12 forward with their general rate case, and they can still
13 ask for either a base rate change or a temporary
14 surcharge in rates to take into account the rate making
15 procedures with respect to Coyote Springs. They still
16 have that ability to do that, because that plant is not
17 coming on line for almost another year. So they can
18 still do that. I'm not -- nothing in my proposal
19 forecloses them from seeking that recovery the day it --
20 in getting recovery the day it passes its commercial and
21 viability test. I'm not saying that they should not get
22 recovery on Coyote Springs if it ends up that that was a
23 prudent thing to do, and we have months to determine
24 that matter.

25 Q. Okay. But even there, with a rate case to be

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1 filed in November, Coyote Springs won't be on line, and
2 again under traditional used and useful theories, it
3 wouldn't go in the rate base until it was operational;
4 isn't that --

5 A. Well, you know, obviously you can -- they
6 could have. If you go in your normal type of sequence
7 here in Washington where you basically take about 11
8 months when the general rate case is filed and when the
9 rates go into effect, yes, there would be a delay. But
10 you could obviously defer that amount, defer the cost
11 and then get that in a temporary surcharge in addition
12 to the base rate recovery. So you could still make them
13 whole from the day it started running, you would still
14 make them whole.

15 Obviously they would have also have had the
16 option, you know, four months earlier or so of filing a
17 general rate case seeking Coyote Springs at that time.
18 But, of course, we just concluded a stipulation that
19 said they would try to stay out of these halls and rooms
20 for a couple of years.

21 Q. This gets back into the questions from
22 Chairwoman Showalter. I would assume a company
23 typically would, when it undertakes a project of some
24 magnitude, would have locked in its financing for the
25 construction of that plant prior to the commencement of

00507

1 the project. Is that a fair --

2 A. But developers normally don't lock in their
3 permanent financing until, you know, they convert it
4 over. It's almost no different than when you build a
5 home and you may take out a construction loan, and then
6 you eventually turn it over. Generally though, the --
7 certainly with -- if you go back to the good old days
8 and when cogeneration when you had a power sales
9 contract in hand, you could get 105% debt financing on a
10 project. Now obviously it's a much more riskier
11 business, but still you can get it -- you normally can
12 get a substantial amount of debt financing on these
13 things.

14 Q. But in the testimony from the company
15 yesterday, it would appear that the project is partly
16 constructed at this point, still doesn't have the hand,
17 the assurance of the additional capital to complete it.
18 But you would not recommend that this Commission in this
19 surcharge take that into account in providing the
20 subject of refund at least and the assurance of rate
21 payer payments in order that the project could be
22 completed?

23 A. That's a very difficult question. Going back
24 to the Commonwealth Edison example, if the sole reason
25 they could not obtain the additional financing was

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1 because the coverage ratios were inadequate because of
2 an enormous construction program, that's the vehicle of
3 a lot of construction work in progress, to raise the
4 cash generation, to allow the completion of the plant to
5 be, to allow the completion of the plant.

6 The problem we have here and the problem
7 you're going to have to struggle with is, this doesn't
8 seem to be that simple. When you look at some of the
9 credit agencies' reports, they talked in terms of the
10 entire corporation. You don't have just an electric
11 utility, a single focus corporation here, but you have a
12 corporation that has many unregulated affiliates, and
13 that's created a problem. And that's where generally I
14 would say a utility of this size if they're just an
15 electric utility, a utility of this size building that
16 one single plant would generally have no problems
17 financing it.

18 Now to the extent I was -- I was not here
19 yesterday, so I did not hear the testimony -- now to the
20 extent you're saying the company is saying investment
21 bankers are not willing to come forward with additional
22 funds to complete the plant just reaffirms in my mind
23 that the problems that this company is having is not
24 just solely related to their electric utility
25 operations. Because again, everything they have

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1 deferred to date, \$109 Million through June, is
2 associated with the market, in the incredible market
3 this past year, and my proposal would give them
4 basically \$83 Million of that amount. So that's --
5 there's much more here than is meeting the eye with
6 respect to just electric utility operating during
7 draught conditions in extraordinary market prices.
8 There's much more going on.

9 COMMISSIONER HEMSTAD: That's all I have,
10 thank you.

11 CHAIRWOMAN SHOWALTER: I have one question I
12 meant to ask.

13

14 E X A M I N A T I O N

15 BY CHAIRWOMAN SHOWALTER:

16 Q. On page 6 of your testimony, line 13, you
17 make reference to some very untimely and possibly
18 imprudent purchases. Are you talking -- is that -- are
19 you referring to the spot market purchases before the
20 FERC order that you reference later?

21 A. Well, I don't know if you could call them
22 spot market.

23 Q. I mean purchases.

24 A. I have a concern, and that would be part of
25 the reasonableness review, regarding a handful of

00510

1 contracts that were entered into the third and fourth
2 quarter for power for the third and fourth quarter of
3 this year in the months of May and June. That's what
4 that was referring to.

5 Q. Okay. So that on page nine of your
6 testimony, lines one through four, you refer to some
7 contracts. Do both pages refer to the same concern?

8 A. Yes, they do.

9 Q. And I realize this is not a prudence hearing,
10 but are you saying that they shouldn't have bought so
11 high?

12 A. No, I'm saying --

13 Q. -- pending a FERC order --

14 A. I'm saying --

15 Q. -- or they should have predicted what the
16 FERC order would be?

17 A. No. That's what I'm saying, I simply need
18 more time to analyse this issue. That's why -- the
19 contracts were executed in May and June, but they were
20 for power deliveries in the third and fourth quarter in
21 particular of the year. So none of those contracts were
22 entered into as of my cutoff date, June 30th. None of
23 the costs associated with those contracts are in that
24 deferred balance. So I'm saying let the company
25 continue to defer all of those contracts and the costs

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1 of all those contracts, and then when there is adequate
2 time and we can look at their decision making progress
3 on a day to day, when you can match up things better,
4 that would be the prudency review phase.

5 Because certainly long before June 19th, I
6 would assert because I went on vacation the week before
7 June 19th, you were aware that FERC was going to issue a
8 high -- very high probability that FERC would issue a
9 price cap decision. So that's the tension in my mind is
10 going -- looking at that period of May and June when
11 they're entering into contracts through the latter half
12 of the year, at what point should they have known we
13 will stop buying at some three digit number because
14 there is some probability that FERC could issue a
15 Westwide price cap decision.

16 Q. My question because I -- oh, to get to the
17 differences between your proposal and the company's,
18 both allow continued deferral, and both allow a later
19 prudency recoverability review. It's that theirs allows
20 actual dollar recovery pending that time of more amount,
21 of more amounts than your proposal would allow?

22 A. Yes.

23 CHAIRWOMAN SHOWALTER: Okay, thanks.

24 JUDGE MOSS: I have just a couple of
25 questions for you, Mr. Schoenbeck.

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1 THE WITNESS: Sure.

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E X A M I N A T I O N

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BY JUDGE MOSS:

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Q. One is sort of a technical clarifying question, if you will. On page 1 of Exhibit 651, your direct testimony, at line 21, you make reference to an ICNU legal brief, and I'm not sure what document you're referring to.

10

A. I think that's something I was anticipating would be filed at the conclusion of this docket.

11

12

Q. But their legal position as you understand it to be?

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14

A. Right.

15

Q. Okay, I just didn't want to be looking for something that I wasn't sure of.

16

17

One way to look at what the company is asking for, asking the Commission to do here I think, is to consider that there are two goals. One is to send a signal to the financial community that is of such a nature that the company will be able to continue accessing moneys that will allow it to operate from day to day. The company is saying we're running out of operating funds, need to borrow to stay solvent, pay the bills, meet the payroll, what have you. Another piece

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1 is the Coyote Springs financing. They also want to --
2 the Commission to enter an order that will send a signal
3 to the financial community that will perhaps enhance the
4 ability to obtain financing for Coyote Springs. And as
5 I understand your proposal, it might promote the first
6 goal but would really not have any effect with respect
7 to the second. Do you agree with that?

8 A. I agree with that, but you could also note
9 just in the issuance of the order that the company could
10 still come forward to seek interim surcharge with
11 related that would be effective on the commercial
12 operational date of Coyote Springs. So you could --
13 because that option is always there.

14 If you think in terms of the company's own
15 proposal, I think Mr. Falkner alluded to it, the idea
16 that they have this deferral balancing kind of proposal
17 going through December of '03. A general rate case if
18 they truly file in November would be decided long before
19 that. So it almost -- the whole notion that you would
20 be deferring anything after -- much after December 2002
21 almost becomes a moot issue, because most of those
22 things would be resolved within the context of the
23 general rate case, including the \$59 Million they're
24 seeking in the recovery of Coyote Springs under their
25 current proposal.

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1 So that timing is still all there, and it is
2 still in my mind adequate to decide that issue to allow
3 a base rate -- a permanent base rate change or a
4 temporary surcharge to allow for the recovery of Coyote
5 Springs. So you could make that clear in your order,
6 that you're just addressing -- you're addressing the
7 extraordinary expenses that the company incurred through
8 June 30th, and you're allowing them continued deferral
9 of all subsequent months and moneys, and that you will
10 decide the appropriateness of the Coyote Springs
11 investment and other capital projects in the context of
12 the general rate case that you expect the company to
13 file in November.

14 Q. And that --

15 A. And to me, that's what the investment
16 community I think would traditionally be expecting from
17 a utility commission. It would decide if the project
18 should be built and should -- if it was a prudent
19 decision, then you will allow them immediate recovery
20 the first day it starts operating if we decide it was a
21 good decision to make.

22 Q. So one option, if I understood your answer
23 correctly, one option would be for the Commission to
24 signal by a statement in any order it enters at this
25 phase that the company will have the opportunity in

00515

1 bringing its general rate case in November to address
2 the question of how to treat the Coyote Springs costs
3 through some sort of a surcharge, or there may be some
4 other options that would demonstrate -- if they
5 demonstrated the prudence of the costs and prudence and
6 so forth to the Commission's satisfaction, that they
7 could implement or propose at least a surcharge that
8 would allow them to avoid the problems of regulatory lag
9 and what have you that might be associated with waiting
10 until the plant was operational to seek -- to include it
11 in rate base?

12 A. You've got it.

13 Q. Now is that the same as or an alternative to
14 some proposal they might make in connection with a
15 general rate case for construction work in progress
16 related to recovery of construction work in progress; is
17 there an alternative to the surcharge or --

18 A. In my mind, they are kind of alternatives,
19 but they could obviously present both possibilities to
20 the Commission and decide which you would prefer.

21 Q. My point simple being, there are alternative
22 accounting treatments that achieve the same result of
23 giving assurance to the financial community that there
24 will be some timely recovery by the company.

25 A. Of their investment.

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1 Q. Of their investment.

2 A. Correct.

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4 E X A M I N A T I O N

5 BY COMMISSIONER HEMSTAD:

6 Q. I want to pursue the Coyote Springs one point
7 further. Again, normally the company would complete its
8 project, the cost would be added to rate base in a
9 general rate case, and the plant would then be
10 depreciated over the life of the plant. And I really
11 should have asked this of the company, and from my
12 understanding, what is the company asking for with
13 regard to Coyote Springs here in this short term
14 environment?

15 A. Well, I think that was on one of the exhibits
16 Mr. Trotter used just this morning showing one of the
17 workpapers in his cross-examination of Mr. Falkner.
18 It's everything. It's the capital costs of -- their
19 projected capital costs of the project, all their fixed
20 O&M, the return on investment at their last authorized
21 rate of return. It's the whole enchilada.

22 Q. But not for the entire cost of the plant?

23 A. Yes, they're seeking recovery based on the
24 plant being operational in June. That's how you get
25 the, on my exhibit again, it's the \$58 Million is the

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1 fixed cost recovery associated with that plant just for
2 that period of time, the twice a month period of time.

3 Q. For the 27 months, so in effect they're
4 asking for an accelerated recovery of what would
5 otherwise have been the commencement of a depreciation
6 schedule at the time that it would typically go into
7 rate bases after a rate case?

8 A. Well, that's where it gets into a little bit
9 of a semantics game. In my view, I tend to agree with
10 you, because that's basically what my testimony says.
11 But from the company's perspective, they're looking at
12 -- they're claiming that if you would allow them 100% of
13 the dollars that they're seeking, there would not be
14 advanced recovery of Coyote Springs until it actually
15 became operational.

16 But in my mind, again, they can do that exact
17 same thing through some of the various mechanisms we
18 have talked about, including filing a general rate case,
19 including seeking a surcharge, allocated premise just
20 solely on the Coyote Springs revenue requirement. They
21 could do all of those things and -- to get the same
22 dollars using different vehicles or tools.

23 COMMISSIONER HEMSTAD: Thank you.

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E X A M I N A T I O N

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2 BY JUDGE MOSS:

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Q. To follow up on your last point then, it's really -- it's largely a matter of perspective. In other words, if you, let's take the hypothetical that the Commission approved the company's proposal, lock, stock, and barrel, there are dollars in there for Coyote Springs. And one way to look at it would be to say that means that the company begins to recover on September 15, 2001, dollars associated with Coyote Springs. Another perspective would be to say, well, no, the dollars we're recovering today are those dollars we have already spent, the 80 some million, and we don't really start picking up the Coyote Springs dollars until June of 2002.

A. Right.

Q. And that's just perspective?

A. It's perspective, and the critical part of it has to do with the amount of dollars that will be recovered. You could think of it in terms of over some period of time they have collected \$100 from the customers, and after the prudency review, you decide -- and they did it just in the first year of the surcharge, a period prior to a base rate change. So you're saying, as a result of the prudency review, none of the costs

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1 should have been allowed but Coyote Springs.

2 So the company's -- under the company's
3 approach, it would be so we've got \$100 recovery
4 associated with Coyote Springs, so even though it may
5 have come earlier, six months prior to the start up,
6 we're okay, everyone is whole.

7 And that's where I'm saying from my
8 perspective, I would call it a prepayment of Coyote
9 Springs, and that's where -- because I'm saying they
10 should not get 100% of every dollar that they're
11 proposing.

12 JUDGE MOSS: Okay. Let's see, this would
13 bring us to the point of redirect, but it is also the
14 point of 12:15 in afternoon, and I think we need to take
15 our luncheon break. I believe there are some other
16 commitments and one thing and another, and that will
17 give Mr. Van Cleve a chance to shorten his questions
18 down to a few, and so we will recess until 1:15.

19 (Luncheon recess taken at 12:15 p.m.)

20

21 A F T E R N O O N S E S S I O N

22 (1:20 p.m.)

23 JUDGE MOSS: We have an additional follow-up
24 question from the Bench before we go to any redirect.

25 CHAIRWOMAN SHOWALTER: That was from me.

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E X A M I N A T I O N

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BY CHAIRWOMAN SHOWALTER:

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Q. Mr. Schoenbeck, I think maybe I was too hungry or something on your -- the last answers you gave to Judge Moss and Commissioner Hemstad, so you may have answered this question. But here's a hypothetical, hypothetical number one. Assume that all of the projections and expenses that Avista is requesting a surcharge for are justified, prudent, recoverable, and will be recovered. If we -- and that we grant their request for the surcharge. For amounts that come in in October, this October, if you take any dollar of the surcharge that comes in, there are different ways I could think you could look at where that dollar is going. One would be that the first dollar in covers the first dollar in the deferral account that is there.

18

A. FIFO.

19

Q. First in-first out, right. Another way would be that X% of the dollar covers certain kinds of expenses, and another percent of the dollar covers other projected expenses?

23

A. We will have a melting pot approach.

24

Q. Okay. Now in that hypothetical, do you feel which way is appropriate in your view?

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1 A. I obviously have a problem with your
2 hypothetical saying every dollar is recoverable.

3 Q. Right, I will change the hypothetical later.

4 A. Taking that as a premise, I would say it
5 almost would not matter. If all the costs are deemed
6 reasonable, then it doesn't matter. What I was trying
7 to raise in my testimony is kind of a more of a first
8 in-first out approach where you don't want to overpay
9 them.

10 Q. Oh, I know, don't change my -- I will change
11 my hypothetical. I'm just trying to change that --

12 A. In your hypothetical, it would not matter.

13 Q. Right.

14 A. Because you're saying you get recovery of
15 every dollar, and every dollar that has been prudently
16 incurred, there's going to be no give back or refund.

17 Q. All right.

18 A. It's a moot issue if you color code the
19 dollars on the first in-first out basis or last in,
20 first out, anything you want to do.

21 Q. All right. I understand there's no
22 difference, but is it analytically more appropriate to
23 think of it one way over another or in any other
24 accounting sense?

25 A. Well, what -- yeah, I would generally -- I

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1 generally think in terms of more first in-first out.

2 Q. All right. So sticking with my same
3 assumption that everything is reasonable and
4 recoverable, on that first in-first out analysis and
5 assuming everything is recoverable, then when it comes
6 to Coyote Springs amounts, am I right that on a first
7 in-first out, those -- revenues covering those expenses
8 would come along later than revenues covering the
9 current deferral account?

10 A. Right.

11 Q. Right?

12 A. And that's basically the company's rebuttal
13 testimony.

14 Q. Okay. And then still sticking with my same
15 hypothetical and the first in-first out analysis, if we
16 have a rate case and concluded in 11 months, let's say,
17 beginning in this November, on that analysis, will we
18 have -- I was about to ask, will we have made any
19 determinations on Coyote Springs before the revenues
20 covering those dollars are paid out under our first
21 in-first out analysis. As soon as I started asking the
22 question, I think I realized the problem with the
23 question, but go ahead and answer it.

24 A. Yeah, you would basically be -- at that point
25 in time, you would basically be getting those dollars,

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1 because it would be very close, and so I'm sure you
2 would have to do a more detailed analysis. But if you
3 did your normal procedures where you would be issuing a
4 decision come October, I would suspect they would have
5 been collecting on Coyote Springs as of some time
6 subsequent to June. But if you have also determined the
7 hypothetical that it's a prudent resource and you would
8 allow the recovery of it anyway, I'm not sure there
9 would be a problem.

10 Q. All right. Now let's switch to a different
11 hypothetical. Assume that only 80% of the expenses and
12 revenue that the company is asking for are going to be
13 ultimately recoverable, and I understand that's not your
14 position, you're saying there's a possibility of it.

15 A. Mm-hm.

16 Q. But I'm going to take that as a kind of worst
17 case scenario. Under your theory, someone else might
18 think only 50% is recoverable, but if only 80% is
19 recoverable, then again, under the first in-first out
20 analysis, for amounts that come in this October and this
21 November, those amounts would be going toward the
22 existing deferral account; is that right?

23 A. You would be getting 100% of the revenues.

24 Q. Right.

25 A. But then it turns out the company would have

00524

1 to refund money back in the -- because you -- ultimately
2 you decided in October or whenever that they should only
3 have gotten 80% of the money.

4 Q. Right.

5 A. That in my mind, again, that's the concern I
6 raised in the testimony, saying then you might get a
7 problem of prepaying certain expenses that ultimately
8 were disallowed in some manner.

9 Q. Right, but now -- but if the deferral -- if
10 the surcharge period is 30 months; is that right?

11 MR. MEYER: 27.

12 A. 27 in their proposal.

13 Q. 27.

14 A. Mm-hm.

15 Q. If we decided that certain amounts were
16 imprudent or not recoverable, then if we made that
17 decision three months before the surcharge period was
18 up, let's say in 24 months, not 27 months, then we would
19 simply cut it off right there. We would say, well, it
20 turned out we -- instead of paying -- instead of paying
21 this over 27 months, we're going to pay it over 24
22 months because we're lobbing off the last three months.

23 A. Right.

24 Q. Though had we known in advance what we were
25 doing, the whole rate might have been lower over 27

00525

1 months instead of a slightly higher rate over 24 months?

2 A. Right.

3 Q. But the rate payers would not actually have
4 paid more than they should have unless 24 out of 27
5 months covers more than --

6 A. The 80%.

7 Q. -- the 80% or whatever amount?

8 A. Right, and that's the way it all works out
9 under that kind of status quo, all else being equal
10 scenario.

11 Q. Right.

12 A. But that's the concern with the percentage
13 amount of the increase where I'm not so sure you get
14 there because of what the increase may cause customers
15 to do, and that's the concern. And that's why I think
16 it's kind of your fiduciary responsibility to get that
17 number as reasonably accurate as you can get it now
18 given this accelerated pace we're all working under to
19 prevent the notion of sometime after the fact saying we
20 overcollected or it was too high of a percentage.

21 Q. Right.

22 A. So that's why I believe there should be a
23 reasonable setting of the initial benchmark or what I
24 call a place holder.

25 Q. But it also depends on what period of months

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1 we set, which is somewhat arbitrary?

2 A. Yeah, well, isn't the 27 month period that
3 the company selected arbitrary? Because they're saying
4 they're going to come in with a rate case in November,
5 so you're going to decide it by October of next year
6 anyway. So already you're going to be deciding the rate
7 case and having adjustments to the base rates similar in
8 the range of 12 to 14 months prior to the end of the
9 surcharge period anyway.

10 So under either my -- the critical thing in
11 this whole process under either the company's proposal
12 or my proposal is really getting going on the general
13 rate case and getting the prudency review going. That
14 really becomes the issue. Where they're saying, you
15 know, trust us, give us 30% now, and we will prove 12
16 months from now that it was all prudent. I'm saying I'm
17 very comfortable looking at your historical forecasts
18 giving you 80% of those dollars, but I've got some real
19 concerns about your forecast, so let's just continue to
20 defer those. I will give you your 80% of the dollar now
21 as a reasonable benchmark of a subsequent reasonableness
22 review recovery, but then you have to defer everything
23 else and look at that in the prudency review. It could
24 be held in conjunction with the general rate case
25 filing.

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1 Q. Is another way to handle it if you add three
2 more months on and make it 30 months with just that much
3 more time to decide prudence in advance, then you
4 stretched out the payments, and should they not be
5 recoverable, you cut it off at 27 months?

6 A. Sure.

7 Q. I mean these are very -- these are moving
8 pieces that we could -- moving pieces of an equation.

9 A. Okay.

10 Q. One of which is what's the rate, another of
11 which is over what period of time, and another is for
12 how much, and that how much is somewhat dependent on a
13 reasonable sense of what most likely will be recovered
14 in any event?

15 A. That's correct.

16 CHAIRWOMAN SHOWALTER: Okay, thanks.

17 JUDGE MOSS: Let's go to the redirect.

18

19 R E D I R E C T E X A M I N A T I O N

20 BY MR. VAN CLEVE:

21 Q. Mr. Schoenbeck, in response to a question
22 from Mr. ffitch, you referred to a problem with the
23 company's hydro forecasts for the rest of the year. Can
24 you tell us what you were referring to?

25 A. Yes, it's probably best illustrated looking

00528

1 at page eight of my pre-filed testimony, which is 651-T.
2 It has to do with the company's forecast for the months
3 that are shown in the bold font under the actual
4 projected column, that the company's recorded results at
5 this point in time through June, and it was a forecast
6 for July through December, it's really an emphasis of
7 the sentence I added, which states that if the company's
8 forecast comes true, you will have had five consecutive
9 months of record low generation in each of the months.
10 If you look over the 60 water year conditions, you would
11 note that there has never been in any one water year
12 more than two consecutive months that set the low for
13 all 60 years, so that's where I start having concerns
14 about a forecast.

15 And, of course, as was noted in one of the
16 company's data responses, they did not assume normal
17 precipitation levels for this period of time. And I
18 stated in my testimony I wasn't too concerned about the
19 months of August and September, because generally the
20 precipitation in those months is relatively low, it
21 doesn't matter if you want to assume 50% of one inch of
22 rain, it doesn't come. But once you get to the final
23 quarter of the year when you start getting more
24 substantial amounts of rain, then I just don't know
25 anyone who has a crystal ball good enough to say there

00529

1 should not be normal precipitation during that quarter
2 of the year.

3 So again, that's how I was trying to finesse
4 some of these issues with respect to the company's
5 forecast by just stopping with the actual costs they had
6 recorded through June of this year.

7 Q. Thank you. You were also asked by the
8 Chairwoman to articulate the differences between your
9 proposal and the company's, and you mentioned the fact
10 that your proposed surcharge would only apply to the
11 deferrals that have been made prior to July 1st, 2001,
12 and I'm wondering if you can articulate what the
13 difference between your position and the company's is
14 with respect to the deferrals that were made prior to
15 July 1?

16 A. Yes, that's -- actually, I would just like to
17 refer to another table in the pre-filed direct testimony
18 on page 13. While the commissioners and I discussed a
19 line adjustment I made with respect to the exhibits,
20 it's really shown by the last column of this table where
21 I have taken into account the fact that implicit within
22 the rate setting process, the company has accepted a
23 certain amount of market and hydro risk.

24 And in my view, they have accepted in the
25 range for the Washington jurisdiction what's reflected

00530

1 as being the difference between one of the lower water
2 years of record, and I chose 1998, out of the 60 water
3 years versus the 60 year average, and that's shown by
4 the last column where for the system as a total it's
5 about \$38 Million, and for the Washington jurisdiction
6 it adds up being \$25 Million to \$26 Million of risk
7 that's implicit within their rates that they have agreed
8 to take on basically through the rate setting process.

9 Q. And is it your position that the company has
10 already been compensated for taking that risk through
11 the rate of return?

12 A. Through the rate of return and the rate
13 setting process both.

14 MR. VAN CLEVE: That's all the redirect that
15 I have, Your Honor.

16 MR. MEYER: Your Honor, I do have some
17 recross.

18

19 R E C R O S S - E X A M I N A T I O N

20 BY MR. MEYER:

21 Q. Mr. Schoenbeck, a series of questions here,
22 but as I begin, let me just address one item back to
23 your page eight of your pre-filed direct. This goes to
24 the hydrogeneration numbers for the months of July
25 through September. Direct your attention to line seven.

00531

1 Was it your testimony that:

2 It is likely that the actual
3 hydrogeneration for the months of July,
4 August, and September should be
5 relatively close to the company's
6 projection due to the historic limited
7 precipitation that occurs during this
8 period of the year.

9 A. Yes, that's my testimony.

10 Q. And you still stand by that?

11 A. Having not seen what your actuals were, that
12 was again based on the assumption that during those
13 months, there's generally not that much precipitation
14 that occurs. The only thing I have seen since then is
15 there has been some additional evidence from data
16 responses to one of our data requests that showed some
17 more precipitation measures. But certainly at the time
18 that this was written, I stood by that testimony.

19 Q. Mr. Schoenbeck, you earlier testified that
20 you were not in attendance at yesterday's hearing?

21 A. That's correct.

22 Q. And so you did not have the benefit of
23 hearing the rather extensive testimony on financial
24 implications both with and without the company's
25 proposed surcharge?

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1 A. No, I did not hear that.

2 Q. Okay. And you did not acquaint yourself with
3 the transcript of that case?

4 A. I have not seen the transcript. I have had
5 relatively what I would characterize as brief
6 conversations regarding the in camera session that was
7 held yesterday, but that's all.

8 Q. Okay. Now earlier during my initial
9 cross-examination of you, I believe we established that
10 you had not analyzed the impact of your proposal in the
11 context of a number of different financial indicators,
12 correct?

13 A. That's correct, basically I did not attempt
14 to recalculate any financial ratio based on my proposed
15 almost 12% increase.

16 Q. Okay, we will return to that in just a
17 moment.

18 The question of subsidiaries, before
19 testifying today, had you familiarized yourself with
20 Mr. Eliassen's testimony?

21 A. I certainly read it.

22 Q. Did you? Do you disagree that he testified
23 that the Avista Capital family of unregulated
24 subsidiaries are expected to be net contributors of cash
25 in 2001 and 2002?

00533

1 A. I did read that testimony. I did not review
2 anything further.

3 Q. Do you have any reason to disagree with that
4 statement?

5 A. No, since I haven't reviewed anything
6 further, I do not.

7 Q. Okay. Do you have any reason to disagree
8 that the subsidiaries, Avista Energy in particular, have
9 been net contributors of earnings and substantially so
10 in the year 2000 and 2001?

11 A. Oh, I believe I did see one more paper that
12 had a subsidiary earnings amount that I did note was a
13 contributing factor to the company's earnings.

14 Q. A substantial contribution?

15 A. It is a large -- I think, I'm sorry, I did
16 not bring it with me, but I think it was in the range of
17 maybe even a six digit number.

18 Q. All right.

19 A. With the dollar amounts in thousands.

20 Q. Mr. Schoenbeck, let's talk about a couple of
21 different time frames. Let's first take the time frame
22 of up until the end of June of 2001 and the level of
23 deferral balances accumulated as of that date; are you
24 with me?

25 A. Yes.

00534

1 Q. And that's, in fact, where you would cut it
2 off, correct?

3 A. That's where I would cut off the surcharge
4 recovery. I would not cut off the deferral.

5 Q. I understand. And that amount as of the end
6 of June of 2001 is approximately \$109 Million of
7 deferral balances?

8 A. That's correct.

9 Q. Okay. And did I earlier understand you to
10 testify that you were in the 95% confidence range that
11 those were, in fact, prudent?

12 A. My value?

13 Q. Yes.

14 A. 95% range that my value, which is \$26 Million
15 less, would probably be considered prudent upon a
16 prudency review.

17 Q. Okay. But that adjustment you made for a
18 risk adjustment wasn't based on your analysis of each
19 contract, each purchase and sale that made up that \$109
20 Million, correct? It was rather an adjustment based on
21 what you characterized or what I think you characterize
22 as normal performing activities out of a general rate
23 case?

24 A. Yes, but it did -- but my analysis did
25 include that component. It did include at least, you

00535

1 know, limited given the time period that there was
2 available to do it, but it did include a limited review
3 of the transactions that were actually entered into
4 during that time period.

5 Q. Also I believe you said during an early
6 portion of your cross-examination that you were, and
7 maybe this is making the same point, but tell me if you
8 disagree, that you were relatively comfortable with the
9 prudence of costs incurred up to July. Do I have that
10 essentially correct in my notes?

11 A. Yes.

12 Q. Okay. Now let's take the next time segment.
13 Let's go from July through September.

14 CHAIRWOMAN SHOWALTER: Can you say what years
15 you're referring to.

16 Q. '01, this is all '01, I'm sorry, so taking
17 the first lump was up through the end of June '01. Now
18 we will visit the period of end of June or beginning of
19 July right through September, okay. Have you reviewed
20 the levels of deferral balances through the end of
21 September as shown on the company's books?

22 A. No, I have not.

23 Q. Do you accept subject to check that as of the
24 end of September, we show deferral balances of
25 approximately \$186 Million?

00536

1 A. Additional for those three months?
2 Q. No, cumulative.
3 A. Okay.
4 Q. So would you agree with that subject to
5 check?
6 A. So an increase of about \$77 Million?
7 Q. Approximately.
8 A. I will take that subject to check.
9 Q. Okay. Now with reference to that \$186
10 Million deferral balance figure representing balances at
11 the end of September of 2001, do any of those balances
12 reflect any Coyote Springs II capital or O&M costs?
13 A. Well, again, I have not reviewed those three
14 deferral reports, but subject to check, I would say no,
15 they probably do not.
16 Q. Probably do not. Would you accept subject to
17 check that it is not until June of 2002 that you see the
18 first entries for Coyote Springs capital?
19 A. Sure.
20 Q. Okay.
21 A. That's on the exhibits.
22 Q. Yes, and I will direct your attention in the
23 process to Exhibit 254 as entered, all right?
24 A. Okay.
25 Q. Okay. So again, let's reset the coordinates

00537

1 here. We're talking end of September, 2001, \$186
2 Million of deferral balances, correct?

3 A. Yes, but those are subject -- this is where
4 it gets dicey, it gets subject to how much though should
5 you be allowed to recover.

6 Q. Okay, well, and we have also established that
7 the \$186 Million does not include at that point in time
8 any capital or O&M costs with respect to Coyote Springs?

9 A. Right.

10 Q. Okay. Now let's take a couple of assumptions
11 here and modify somewhat what you propose. I will do
12 this in a subject to check fashion if we can proceed
13 down that path. First of all, I'm going to ask you to
14 accept subject to check that the balance of \$186 Million
15 reflects approximately so the balance of deferrals as of
16 the end of September.

17 A. Out of curiosity, do you have the exact
18 figure for the end of August?

19 Q. Let's see, end of August is \$165 Million.

20 A. Okay, thank you.

21 Q. Okay. So the first assumption is we take the
22 \$186 Million figure, which as you testified earlier does
23 not include any Coyote Springs, okay.

24 A. Yes.

25 Q. Assumption number two is your assumption that

00538

1 we use a 15 month surcharge recovery period. Are you
2 with me so far?

3 A. Mm-hm.

4 Q. Okay. Now if we subtract from the \$186
5 Million figure as of the end of September of this year
6 the \$53 Million that you recommend as an amortization of
7 the PGE credit, and if we also give you the benefit of
8 the doubt and subtract \$25 Million for your implicit
9 risk adjustment, is the resulting figure of \$108 Million
10 if I have done my math correctly?

11 A. I would say you haven't done your math
12 correctly. Since the \$25 Million or \$26 Million is a 12
13 month number, you're going to -- are you recovering the
14 132 over the you said 15 months?

15 Q. Yes.

16 A. Well, if you would begin -- the concern was
17 just the ratioing. If you take the 108 and realize
18 that's not an annual number, that would be what would
19 have to be recovered over 15 months, not 12.

20 Q. Okay. And if we were to take -- if we were
21 to take the \$108 Million, okay, let's just assume that
22 we're 108 without factoring into this the revision, I'm
23 going to characterize it for this purpose as a
24 relatively minor revision, take the \$108 Million, and if
25 that were to be divided by a figure that represents the

00539

1 15 months of revenue that we might realize through the
2 surcharge, and would you agree that that 15 month
3 revenue figure would approximate \$300 Million?

4 A. Probably, because your annual revenue is
5 around 240.

6 Q. So you ratchet up the annual revenues for a
7 15 month period. So we divide 108 by 300 million, would
8 you agree subject to check that that translates into
9 approximately a 36% surcharge?

10 A. Certainly, I'm sure the math works out close
11 to that.

12 Q. Okay. And the only thing we have done in the
13 process, Mr. Schoenbeck, is to take the balance at the
14 end of the September and use your 15 month amortization
15 period and use your deduction for implied risk
16 adjustment and use your proposed amortization of the PGE
17 credit, correct?

18 A. Right.

19 Q. Okay.

20 A. So the only place where we disagree then,
21 just to make sure, is you have included in your number
22 since it was a September number, all the contracts,
23 those July, August, September contracts that you had
24 entered into?

25 Q. That is correct. Now you understand that

00540

1 those contracts that would have an impact in the July,
2 August, September 2001 time frame are subject to a later
3 prudence review, correct?

4 A. I'm assuming the whole \$186 Million is
5 subject to a later prudence review actually.

6 Q. So it would not be fair at this point to
7 either assume that they were prudent for your analysis
8 or were not; is that correct?

9 A. Well, that's where I think it kind of does,
10 and that's where we keep having this problem. I think
11 we should use our best efforts to try to come up with a
12 reasonable value of what is -- what we believe to be
13 prudent and allow that into rates in the surcharge now.
14 So that's why I sidestepped this issue by cutting it off
15 at the end of June, looking to your actual costs that
16 were booked, saying yes, I'm relatively confident 95%,
17 some high confidence level, these costs would be deemed
18 prudent, so let's allow the company to recover those,
19 and let's allow them to continue to defer all other
20 costs.

21 Q. Mr. -- I'm sorry.

22 A. Because I think it matters. I think people
23 should pay now for the value of the products they should
24 expect.

25 Q. Mr. Schoenbeck, we have already established

00541

1 that you were not here to testify as to the impact of
2 your proposal, whether it be with reference to Avista's
3 credit ratings or otherwise access to capital markets
4 through equity or debt financing, correct?

5 A. No, that was not the focus of my analysis at
6 all.

7 Q. Okay. Can you state with any degree of
8 assurance to this Commission that your proposal if
9 adopted intact would preserve the company's ability to
10 finance Coyote Springs II?

11 A. What degree of confidence did you say?

12 Q. Any reasonable degree of assurance that with
13 what you propose, the company would be able to finance,
14 access the markets to finance Coyote Springs II.

15 A. I guess the way I would answer it is this
16 way. Based on my experience, if this was just a
17 electric utility that was focusing on just its regulated
18 operations, they had a deferred balance of either \$109
19 Million and \$186 Million, then we would give them either
20 \$83 Million of it or the full \$186 Million, I would
21 certainly think that would be adequate enough for the
22 financial community to go forward and allow Coyote
23 Springs to be completed.

24 Q. But you testified that you had done no
25 analysis, Mr. Schoenbeck.

00542

1 A. No because --

2 Q. Of the impact, just let me finish, of the
3 impact of your proposal on the company's ability to
4 access capital; wasn't that your testimony?

5 A. That is my testimony.

6 Q. Okay.

7 A. That's why I said I would -- I gave my answer
8 based on my experience.

9 Q. Okay. Do you know or do you have a sense for
10 whether or not based on your financial analysis or lack
11 thereof whether your proposal would constitute the sort
12 of "plan" that would provide comfort to the financial
13 community and free up needed financing? Is it the sort
14 of plan they're looking for, Mr. Schoenbeck; do you
15 know?

16 A. I suspect they're looking for a plan that's
17 akin to the -- the more dollars they can get, I'm sure
18 the better off you are. That would be the case of any
19 utility. But I guess I continue to say, as opposed to
20 looking at the corporate entity from the financial
21 investment perspective, I think it's also important to
22 look at the electric utility from the customers'
23 perspective.

24 Q. Excuse me, the question was from the
25 financial perspective. Your proposal, Mr. Schoenbeck,

00543

1 to cut off for purposes of this surcharge recovery
2 balances at the end of June of 2001 was one part of what
3 you proposed. Didn't you also recommend that we
4 continue the deferral mechanism?

5 A. Yes.

6 Q. Okay. And in that respect, I think we have
7 been through this before, you may differ somewhat from
8 the Staff proposal. Would an order from this Commission
9 which simply adopts end of June 2001 figures for the
10 deferral balance for purposes of the surcharge recovery
11 and yet simply maintains a deferral mechanism to account
12 for subsequent deferrals, would that constitute the sort
13 of signal to the investment community that would be
14 needed to free up financing?

15 A. Well, again, in my mind, if you -- when you
16 caveat the order saying the explicit recognition that
17 the balances would continue to accrue, they would be
18 subject to reasonableness review, coupled with the fact
19 that you get some assurance as opposed to under the
20 company's proposal where the financial community has no
21 idea how much of the 37% would ultimately be deemed to
22 be prudent, you can give some I believe relatively high
23 comfort level with respect to there would be actually a
24 very small probability of recharge at the 12%, coupled
25 with the fact that you're not foreclosing any issue with

00544

1 respect to Coyote Springs, and you can maybe even signal
2 that may be a good investment for the company to get
3 into with the ability to change base rates commensurate
4 when it's operational, commercial viability date, that's
5 all strong signals in my mind.

6 Q. Mr. Schoenbeck, you propose after your
7 several adjustments essentially to recover was it \$84
8 Million through your surcharge proposal?

9 A. Yes.

10 Q. Okay. And we have established that
11 regardless of how the prudence portion of the hearing
12 comes out that the end of September balances were not
13 \$83 Million, but projected to be \$186 Million, correct?

14 A. Projected, right.

15 Q. Let's assume that it takes nine months to
16 complete a prudence evaluation, okay. Would you agree
17 with me that under the company's proposal, the company's
18 proposal, that the dollars collected during this nine
19 month period would be approximately \$63 Million, subject
20 to check?

21 A. That's very close, right.

22 Q. Okay. And would you agree with me subject to
23 check that that \$63 Million would represent only 34% of
24 the expected balance, of the expected deferral balance,
25 as of the end of September of 2001, which is \$186

00545

1 Million? Do you agree subject to check?

2 A. Certainly.

3 Q. Okay. Mr. Schoenbeck, I assume that you read
4 the company's rebuttal testimony?

5 A. Yes, I did.

6 Q. Okay. And are you familiar with
7 Mr. Norwood's testimony?

8 A. I did read it.

9 Q. Okay. And didn't he propose and so state in
10 his rebuttal testimony that at the conclusion of the
11 November 2001 general rate case, the company would
12 modify the surcharge amount and the duration of the
13 surcharge if needed in order to reflect the outcome of
14 the general rate case. Then he continues on:

15 Therefore all parties will have the
16 opportunity in the general rate case to
17 address both the duration and the amount
18 of the surcharge to be in place at the
19 conclusion of the general rate case.

20 Do you recall that in his testimony?

21 A. I vaguely recall that now that you have given
22 me a better recollection, thank you.

23 Q. Okay. Mr. Schoenbeck, just let me revisit
24 one item, then I think I will finish up here. I drew
25 your attention earlier to page eight of your pre-filed

00546

1 testimony. You spoke to a likely hydrogeneration for
2 the period July, August, and September. Do you recall
3 that?

4 A. Yes.

5 Q. And I believe we established that your
6 testimony was that it would be in your view:
7 Relatively close to the company's
8 projection due to the historic limited
9 precipitation that occurs during this
10 period of the year.

11 A. Correct.

12 Q. Okay. Now that time frame, July through
13 September, if we compare that with the deferral balances
14 that we show of \$186 Million also at the end of
15 September, are you with me?

16 A. Mm-hm.

17 Q. Okay. Does that lend any further credence to
18 the company's projections as of the end of September of
19 \$186 Million?

20 A. Further credence, you mean does it verify
21 that the company was on target with respect to those
22 projections?

23 Q. Yes.

24 A. Yes. And again, it's much easier to be on
25 target with respect to precipitation, because if you get

00547

1 one inch rain in the month of August and you say I'm
2 only going to get 50%, that doesn't have much of an
3 impact. But if you say in a month when I'm going to get
4 eight inches of rain is normal rain, I'm only going to
5 get 50% or 75% of that amount, it makes a great deal of
6 difference. That's why I recognize that you should have
7 been relatively accurate for those months. But also it
8 brings into question in my mind the last three months
9 when you did not go back to normal precipitation levels.

10 MR. MEYER: Thank you, that's all I have.

11 JUDGE MOSS: We have a couple of questions
12 from the Chair.

13 CHAIRWOMAN SHOWALTER: I'm going to ask some
14 questions before redirect just so that redirect can
15 cover it.

16

17 E X A M I N A T I O N

18 BY CHAIRWOMAN SHOWALTER:

19 Q. Is the main reason you want to cut off the
20 recovery but not the deferral at the end of June 30th
21 that you have what you characterize as a 95% degree of
22 confidence that your lower amount will be recovered, but
23 you have doubts, I gather, about some contracts that
24 were executed, I guess they were executed in June but
25 for a later period of time.

00548

1 A. Well, more prior to June, yes, but that's
2 fundamentally the issue.

3 Q. All right. Is there anywhere in this record
4 that states the terms that those contracts were entered
5 into, the dollar amount basically?

6 A. I have not calculated the specific dollar
7 amount, but looking at the prices and the size of the
8 contract, it would be a significant amount of money.

9 Q. Well, I guess what I'm trying to get at is
10 you are saying, I think, that you believe we will find
11 those contracts not recoverable because for whatever
12 reason the company should have known not to buy at such
13 a high price; is that right?

14 A. It's a concern.

15 Q. Right.

16 A. You may have stated it just a little bit too
17 strongly.

18 Q. Yes, that's right.

19 A. I would have liked more time, and that's why
20 I cut it off where I did, because there is a timing
21 issue in my mind that I need to work through before I
22 can come to that conclusion. But like I said, I was
23 highly confident of the June 30th date, that those -- I
24 did not have a problem with those contracts and
25 agreements for the power that was delivered during that

00549

1 period. So it was again the concern that I believe rate
2 payers should pay for the costs that they should bear,
3 and I have a concern that some of those contracts may be
4 not prudent when they were entered into. But I need
5 more time to make a solid or more comfortable
6 determination. I'm not, sitting here today, I'm not
7 confident enough to say, yes, I would testify that those
8 contracts were imprudent.

9 Q. All right.

10 A. I need more time.

11 Q. But those contract amounts and the dollar per
12 megawatt hour that they were purchased at is or is not a
13 part of this record as far as you know?

14 A. Oh, they're part of the record.

15 Q. Can you help, can you point to me where?

16 A. Yeah, there was two or three places. There
17 were some contracts were given in response to the Staff
18 data requests. Some additional longer term contracts,
19 I'm not so sure any of my concerns fall under that
20 category, were given in response to ICNU data requests.
21 So there's two places where you can look at all the
22 contracts that the company has entered into.

23 Q. Well, our record is of the exhibits, so not
24 the data requests, so --

25 A. Oh, I'm sorry, I'm sorry, no. These are all

00550

1 -- I don't believe any of the contracts have been
2 entered into -- I have tried very carefully not to use
3 any confidential exhibits or anything.

4 Q. Thank you.

5 Oh, and then one other question on the issue
6 of projections of hydro years. On your chart on page
7 eight from your testimony has various months in bold
8 which show what the company's projections are. One of
9 the things I have heard in other discussions of this
10 draught is that an extended period of draught is
11 somewhat different than one bad month of rain and then a
12 better month of rain. Because if there is month upon
13 month upon month of draught, then even if you get some
14 normal weather, your reservoirs are not up to where they
15 should be to run, and so you can't really look at a
16 normal month of rain. You have to look at that month of
17 rain in the context of what has preceded it, i.e., a
18 draught. Have you taken that into account or has the
19 company taken it into account? Is that provided for in
20 this analysis?

21 A. The company has definitely taken it into
22 account with respect to ground absorption when the
23 ground is more dry, that type of thing, in addition to
24 the restoring of the water levels behind the dam, so the
25 company has taken it into account. My major difficulty

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1 was they did not assume normal precipitation for the six
2 months of the forecast. And again, for the second,
3 third quarter of the calendar year, it doesn't matter
4 much, because you don't get much water that quarter.

5 Q. Okay.

6 A. But for the last quarter of the year, they
7 have in my mind no justification not to have assumed at
8 least average rainfall at that level as a starting
9 point.

10 Q. Then on the question about what to assume
11 about future rain, which obviously is problematic, there
12 are periodic long range forecasts about whether we will
13 have a dry winter or not, and I do seem to recall in the
14 last month or two a prediction that we were going to
15 have another dry winter.

16 A. Okay.

17 Q. I don't know how they make those projections.

18 A. That was a solar flare projection. They said
19 it would be dry for two years.

20 Q. All right. So it doesn't -- isn't there some
21 scientific method for making projections about the
22 weather, obviously probably not highly reliable?

23 A. It's been my experience that I don't know.

24 Q. So in your view, you said just assume that
25 for any month more than a couple of months out, you

00552

1 should assume normal weather conditions?

2 A. That's what I would do.

3 Q. But obviously not everybody does do that,
4 because there is some industry that tries to project
5 weather conditions.

6 A. In what I would call normalized utility rate
7 making, I think it's generally done that way, where you
8 pretty much assume, you know, normal hydro conditions.
9 In a lot of the hydro studies, they used to do it, I
10 don't think they do it any more, they used to assume
11 even if you had the driest year for the last several
12 months that the next month, the next day would be normal
13 water. And again, you know, obviously it has been an
14 extraordinarily poor year this last year and -- but at
15 some point in time, you do have to assume back to normal
16 precipitation, just a matter of how far out do you delay
17 that.

18 CHAIRWOMAN SHOWALTER: Thanks.

19 MR. MEYER: Your Honor.

20 JUDGE MOSS: Before we go ahead, I'm going to
21 issue a Bench Request orally, and that would be for the
22 company's purchase contracts entered into since May 1,
23 2001, and you won't need a follow up in writing.

24 MR. MEYER: No.

25 JUDGE MOSS: Okay, that will be Bench Request

00553

1 Number 2, and if I can get through to the appropriate
2 sheet, we will reserve Exhibit Number 4 for that.

3 And I may not have mentioned earlier, we will
4 reserve Exhibit Number 3 for the company's response to
5 the written Bench Request that I served on everybody
6 this morning.

7 MR. MEYER: I do have -- I'm sorry.

8 JUDGE MOSS: Well, I was just going to say,
9 we'll just make that on an as soon as possible basis.

10 MR. MEYER: And the understanding that we
11 will be providing that on a confidential basis.

12 JUDGE MOSS: I had assumed as much, yes,
13 that's perfectly all right.

14 MR. MEYER: I do have just one matter, and
15 it's in the interest of making sure that the record is
16 accurate, and I believe Mr. Schoenbeck made an
17 observation about what he understood the company had
18 assumed or not assumed by way of normal precipitation
19 for the end of the year, so I would like to ask one
20 brief subject to check question of this witness.

21 JUDGE MOSS: It would be important to be
22 clear on that.

23 MR. MEYER: Thank you.

24

25

00554

1 R E C R O S S - E X A M I N A T I O N

2 BY MR. MEYER:

3 Q. Mr. Schoenbeck, would you accept subject to
4 check that the company used normal precipitation for the
5 July through December period of 2001?

6 A. No, I would not, because I have before me a
7 Confidential Request Number 3.3 that I brought several
8 copies of if people would like to see it. This is what
9 I relied on in my testimony.

10 MR. MEYER: May we have just a moment off the
11 record, please.

12 JUDGE MOSS: All right, we're off the record.
13 (Discussion off the record.)

14 JUDGE MOSS: Let's do be back on the record,
15 and let's do get this cleared up one way or the other.

16 MR. MEYER: Because we don't have the records
17 here to essentially allow this witness to accept it
18 subject to check, we would ask that you give us a Bench
19 Request, and we will provide that, what our records were
20 with reference to assumptions used on normal precip
21 between July and December at the end of this year, and
22 that way it gets into the record, and it's done right.

23 JUDGE MOSS: That's agreeable.

24 MR. VAN CLEVE: We have no objection.

25 JUDGE MOSS: I have always wanted to say

00555

1 this, make it so.

2 MR. MEYER: Okay, and with that, that is all
3 I have, I think.

4 JUDGE MOSS: Then where are we, redirect on
5 the recross, I believe.

6 MR. VAN CLEVE: Just a couple of points of
7 clarification.

8

9 R E D I R E C T E X A M I N A T I O N

10 BY MR. VAN CLEVE:

11 Q. Mr. Schoenbeck, you were led through a series
12 of hypotheticals based on the company's representation
13 that the deferral balance at the end of September would
14 be \$186 Million. Do you recall that?

15 A. Yes, I do.

16 Q. And that led you to a calculation of a 36% or
17 the company to allege that it would be 36% subject to
18 check over a 15 month period. Do you recall that?

19 A. Yes, I do.

20 Q. And is that 36% for the same time period that
21 the company's 36.9% rate increase is proposed for?

22 A. No, the hypothetical was for 15 months, and
23 the company's proposed period has announced 27 months,
24 so there would be another year of revenue under the
25 company's proposal.

00556

1 Q. With respect to the purchase contracts that
2 the Commission requested in the Bench Request, would it
3 be necessary to look at both purchases and sales to
4 judge whether the amounts that are in the deferral
5 account are prudent?

6 A. Maybe I wasn't listening carefully on the
7 Bench Request. There is a response by the company in
8 response to data requests that does give both purchase
9 and sales contracts. I'm assuming they will give both
10 to the Bench Request.

11 MR. MEYER: That's what we understood.

12 JUDGE MOSS: That's fine, everybody is on the
13 same page.

14 BY MR. VAN CLEVE:

15 Q. And does the information that the company
16 provided about the amount of the deferral balance as of
17 the end of September change your recommendation to the
18 Commission in this case?

19 A. No, it does not.

20 MR. VAN CLEVE: That's all I have.

21 JUDGE MOSS: Thank you, that would appear to
22 complete the questioning, Mr. Schoenbeck. We certainly
23 appreciate you being here today, and I have been making
24 the witnesses subject to recall, although we're not
25 anticipating having anybody back, I will just do that as

00557

1 a formality and release you from the stand.

2 THE WITNESS: Thank you.

3 JUDGE MOSS: And I believe that brings us to
4 Staff's witnesses, and Mr. Elgin will be first; is that
5 right?

6 MR. TROTTER: Yes, the order of witnesses is
7 Mr. Elgin, Mr. Schooley, Mr. Lott, and Mr. Parvinen.

8 JUDGE MOSS: Okay.

9

10 (The following exhibits were identified in
11 conjunction with the testimony of KENNETH L. ELGIN.)

12 Exhibit 451-T is Pre-filed direct testimony.
13 Exhibit 452 is KLE-2 List of Prior Proceedings in which
14 Mr. Elgin Testified. Exhibit 453 is KLE-3 Transmittal
15 letter and Petition of Avista Corporation, Docket No.
16 UE-000972 (filed June 23, 2000). Exhibit 454 is KLE-4
17 Commission Order Approving Establishment of a Deferral
18 Mechanism to Track Power Cost Expenses (August 9, 2000).
19 Exhibit 455 is KLE-5 Transmittal letter and Request for
20 Modification of Original Petition of Avista Corporation,
21 Docket No. UE-000972 (filed December 21, 2000). Exhibit
22 456 is KLE-6 Commission Order Granting Request To Modify
23 Power Cost Deferral Mechanism (January 24, 2001).
24 Exhibit 457 is KLE-7 Commission Order Approving and
25 Adopting Settlement Stipulation (May 23, 2001).

00558

1

2 Whereupon,

3

KENNETH L. ELGIN,

4 having been first duly sworn, was called as a witness

5 herein and was examined and testified as follows:

6

7

D I R E C T E X A M I N A T I O N

8

BY MR. TROTTER:

9

Q. Mr. Elgin, do you have before you what has
10 been marked as Exhibit 451?

11

A. Yes, I do.

12

Q. That's designated your proposed direct
13 testimony. If I asked you the questions that appear
14 there, would you give the answers that appear there?

15

A. Yes, except for I would note on page three,
16 line two, there would be no need for me to offer Exhibit
17 KLE-7. That is Exhibit 1 in this proceeding, so that
18 line should read I'm sponsoring Exhibits KLE-2 through
19 KLE-6.

20

Q. And KLE-2 is a list of prior proceedings in
21 which you have testified. Is that exhibit true and
22 correct?

23

A. Yes. I just would note with one minor
24 change. I had also, at the very end, I testified in the
25 Commission's consolidated proceedings for Puget Sound

00559

1 Energy, Avista Corporation, and Pacific Power and Light
2 regarding the Centralia and issues surrounding the sale
3 of that facility.

4 Q. With that addition, verbal addition, the
5 exhibit is true and accurate?

6 A. Yes, it is.

7 Q. You also sponsored Exhibits 453 through 456,
8 which are documents filed with the Commission. Are
9 those correct copies of what they purport to represent?

10 A. Yes, they are.

11 MR. TROTTER: I would move the Commission on
12 Exhibit 451 through 456.

13 JUDGE MOSS: There being no objection, those
14 will be admitted as marked.

15 MR. TROTTER: The witness is available for
16 cross-examination.

17 JUDGE MOSS: All right, we will pause
18 momentarily and give the Chairwoman an opportunity to
19 return, but we will stay on.

20 THE WITNESS: Your Honor.

21 JUDGE MOSS: Do you want to do this on the
22 record?

23 THE WITNESS: Yes, please.

24 JUDGE MOSS: Okay, go ahead.

25 THE WITNESS: I would also note that

00560

1 regarding the admission of Exhibit KLE-7, I would note
2 that the reference on page 12, line 11 of my testimony,
3 that should -- sentence should read, now this order is
4 Exhibit 1, period.

5 JUDGE MOSS: Thank you.

6 THE WITNESS: You're welcome.

7 JUDGE MOSS: All right, let's -- the witness
8 is available for cross-examination, and our order calls
9 for Mr. Meyer to proceed.

10 MR. MEYER: Very well.

11

12 C R O S S - E X A M I N A T I O N

13 BY MR. MEYER:

14 Q. Good afternoon.

15 A. Good afternoon.

16 Q. In your testimony, Mr. Elgin, you summarize a
17 number of Staff's recommendations, some of which I think
18 you were responsible for developing, and others other
19 witnesses were responsible for, correct?

20 A. Yes.

21 Q. Okay. Essentially among the conditions that
22 Staff taken as a whole would recommend for this
23 Commission are the following. First of all, is it true
24 that Staff recommends that the deferred accounting
25 treatment previously authorized should terminate on June

00561

1 30th, 2001?

2 A. Yes.

3 Q. Secondly, is it Staff's recommendation that
4 the surcharge relief should only continue for a period
5 of 90 days?

6 A. No.

7 Q. Okay. Then the 90, the reference in your
8 testimony and that of others to a 90 day duration of the
9 surcharge is a reference to what?

10 A. The 90 days would be in reference to if you
11 look on page four, line one, it's conditioned on the
12 company filing Phase II in this docket to address the
13 issues outlined in the orders that set up the deferred
14 accounting and then also the company filing a general
15 rate application so that the Commission would have all
16 the evidence before it in order to determine the amount
17 of interim relief necessary under the traditional
18 interim relief standards from the PNB order.

19 Q. Well, let's be clear on this. Are you
20 saying, Mr. Elgin, that if the company makes those
21 filings, and let's not argue at this point over the
22 timing of those filings, that if we make those filings,
23 that the Staff proposal is for the surcharge to continue
24 in effect until those filings are resolved?

25 A. No. What the Staff recommendation is is that

00562

1 for the amount that we recommend to be placed into
2 effect subject to refund at the end of this proceeding
3 would continue should the company make those filings and
4 show in a general rate application that those funds
5 under traditional interim standards should continue to
6 operate while we determine the ultimate outcome of the
7 general rate case that we recommend that the company
8 file.

9 Q. But is it your assumption, Mr. Elgin, that
10 the company will present evidence, and this Commission
11 will rule, whether it be Phase II or in a general rate
12 case, with respect to prudency matters within the 90 day
13 period?

14 A. My recommendation is that the Phase II would
15 be resolved within 90 days, and also within that 90 day
16 period that we would resolve the company's application
17 for interim rate relief under the general rate case.

18 Q. So are you recommending that this Commission
19 establish a hearing schedule that would allow the
20 parties an opportunity to address all of the issues that
21 had previously been deferred by this Commission out of
22 this proceeding and into a prudency review proceeding
23 and that those issues, all of them, would be resolved in
24 90 days?

25 A. I'm not sure I understand what you mean by

00563

1 all. It's the issues --

2 MR. TROTTER: Excuse me, Your Honor, I think
3 the witness misspoke before. The Staff recommendation
4 is that the Phase II be resolved expeditiously, and I
5 think Mr. Elgin said it would be resolved in 90 days,
6 and I would just ask him to rethink that.

7 THE WITNESS: Oh, yes.

8 MR. TROTTER: He may have slipped.

9 THE WITNESS: Yeah, it was a slip, I was
10 thinking about --

11 JUDGE MOSS: Mr. Trotter, I don't mind you
12 posing questions to the witness on redirect to clear
13 something like that up, but I don't want you testifying
14 for him, so let's follow the usual course of events
15 there.

16 MR. TROTTER: I apologize, I just saw it
17 going down a completely wrong track.

18 JUDGE MOSS: I understand, and I have been a
19 little bit lax because counsel have been conducting
20 themselves very, very well in this proceeding and doing
21 an excellent job, but I think it's important that if we
22 want to interrupt a witness that we direct the comments
23 to the Bench and that they be in the nature of the usual
24 form of objections or requests for clarification. Then
25 we can talk about that and decide what we're going to do

00564

1 rather than just going forward in that fashion. Because
2 what has essentially happened here is that you have
3 implanted a suggestion in the witness's mind, and that's
4 not really appropriate, so let's not do that.

5 MR. TROTTER: I apologize, I won't do it
6 again.

7 CHAIRWOMAN SHOWALTER: As long as we're
8 interrupting this question, it's not clear to me what
9 Phase II actually means, so you might try to clarify
10 that so that your answer is clearer to me.

11 BY MR. MEYER:

12 Q. Let's begin by doing that first of all. What
13 issues do you believe should find their way into Phase
14 II of this or some other docket?

15 A. These are the issues that the Commission
16 addressed its notice of hearing in this docket, and
17 those had to do with the prudence of the purchase of the
18 company's actions with respect to the resource decisions
19 it made, whether or not the deferral mechanism is
20 appropriate, whether or not it is appropriate to recover
21 these costs under a deferred accounting, and whether the
22 company optimized its resources for the benefit of rate
23 payers, and those are the issues.

24 If you would turn to Exhibit 454, those are
25 the conditions that the Commission set up in its order

00565

1 initially approving the company's deferred accounting
2 treatment. And then if you would turn to Exhibit 456,
3 on it would be page -- the first page, but it's
4 identified as page two in this docket, the issues which
5 I have already mentioned plus a proposal for cost of
6 capital offset. That's Phase II is what Staff had in
7 mind.

8 Q. Okay. Mr. Elgin, you have identified five or
9 six issues including prudence and continued use of the
10 deferral mechanism, whether the company optimized its
11 resources, the need for a cost of capital adjustment or
12 offset, as falling within the confines, if you will, of
13 Phase II, correct?

14 A. That's correct.

15 Q. Okay. Is it your belief that those issues
16 could be sufficiently addressed within 90 days from the
17 date this Commission issues its order in this surcharge
18 case?

19 A. I believe for the amounts on the company's
20 books for the deferral between June 30th, July 1st,
21 2000, and June 30, 2001, that we would work
22 expeditiously, and we would make every effort to
23 accomplish that in 90 days.

24 Q. In 90 days. Suppose that such a proceeding
25 addressing those five or six issues and whatever else

00566

1 occurs by the way of additional issues can not be
2 resolved, suppose those issues can not be resolved
3 within that 90 day time period, is it Staff's position
4 that the surcharge should remain in effect until such
5 time as those issues are resolved in a Phase II
6 proceeding?

7 A. No, the Staff recommendation in regard to the
8 amount that we would be collecting subject to refund is
9 on -- starts on page four, line nine, and it would be
10 incumbent upon the company to file and request a general
11 rate application at the same time. And to the extent
12 that it believes that emergency relief is warranted
13 beyond the initial 90 day term, then it would file
14 testimony and exhibits under the Commission's initial
15 interim rate standards and seek recovery or the
16 continuation of that.

17 Q. Well, then could you foresee a situation,
18 Mr. Elgin, where there would be an interruption or a
19 lapse, if you will, in surcharge recovery between the
20 expiration of the 90 day period that you spoke to and
21 any reimplementations, for lack of a better term, of a
22 surcharge based on a subsequent filing by the company?

23 A. My experience and -- with interim rate relief
24 is that those cases have been done pretty quickly after
25 the company has filed its initial rate request, because

00567

1 we are dealing with an emergency. I recall in an '87
2 case, Washington Water Power filed for emergency rate
3 relief, and I believe that the company presented
4 testimony and exhibits, and I recall that within a 45 to
5 60 day period, the Staff had filed a response to those,
6 and we were prepared to go to hearing within that time
7 frame to get that issue resolved as to the magnitude of
8 the interim rate relief that was necessary.

9 Q. So --

10 A. So my experience with those is they are
11 processed expeditiously, fairly quickly.

12 Q. And, in fact, this Commission has processed
13 this proceeding fairly expeditiously, correct?

14 A. Correct.

15 Q. But in order for this Commission to process
16 this proceeding expeditiously, the company had to start
17 the process with a filing that was made in the middle of
18 July, correct?

19 A. Yes.

20 Q. Okay. And that allowed the process in a very
21 compressed time frame to unfold with the anticipated
22 date of an order sometime on around the 20th or 21st or
23 not later than that in September?

24 A. That's the time frame that we're attempting
25 to achieve.

00568

1 Q. Okay. Now suppose or assume with me, if you
2 will, that the company is concerned that it not
3 experience a lapse in surcharge relief and that secondly
4 there do not appear to be reasonable prospects for the
5 completion of Phase II within 90 days. Would it only be
6 sensible as a precautionary measure for the company to
7 file say within a month of receiving this Commission's
8 surcharge order in this case, file a request to extend
9 its surcharge to allow that processing to occur prior to
10 the end of the 90 day period that you spoke of?

11 A. I have not given that any consideration. I
12 don't know what would be the appropriate thing to do in
13 that circumstance.

14 Q. Okay. But if the company thought that that
15 was the precautionary position it ought to take to
16 prevent a lapse, how will we really have advanced the
17 ball with respect to surcharge relief if we're right
18 back before this Commission 30 days from now with
19 another petition to make sure that this relief
20 continues?

21 A. Well, I guess it would be incumbent upon the
22 company to make the filings that it deems necessary and
23 whatever pleadings. I believe that if the company has a
24 need for interim rate relief under the traditional
25 standards, they can file, and we would like to see that

00569

1 evidence. That's the Staff recommendation.

2 Q. Mr. Elgin, is there -- can you direct me to
3 any financial analysis anywhere in the Staff case that
4 demonstrates that the company's need for financial
5 relief does not extend beyond 90 days from the date of
6 this Commission's order?

7 A. Well, the evidence that we have is based on
8 projections for a period through 2003, and what we are
9 looking for is a general rate case to examine all of the
10 evidence surrounding the need for interim rate relief.
11 What we have now are projections about deferrals. We --
12 and the Commission has had a longstanding history that
13 projections and long-term financial indications are
14 inherently suspect. And so what we're looking at are
15 the immediate short-term needs of the company in the
16 context of a fully restated results of operations, so.

17 MR. MEYER: Your Honor, this is not
18 responsive to the question. Would you direct the
19 witness to respond to the question I asked, please.

20 MR. TROTTER: May I respond to that?

21 JUDGE MOSS: Go ahead.

22 MR. TROTTER: It is absolutely responsive.
23 The company, as Mr. Elgin has said, is projecting out 27
24 months, and Mr. Elgin has cited the orders that oppose
25 that approach.

00570

1 JUDGE MOSS: I think the question had to do
2 with financial analyses, didn't it?

3 MR. MEYER: Yes.

4 BY MR. MEYER:

5 Q. The question simply put, and I will reask it,
6 can you direct me, Mr. Elgin, to anywhere in the Staff
7 case where there is a financial analysis demonstrating
8 that the company does not, does not need surcharge
9 relief that extends beyond 90 days?

10 A. Well, Mr. -- I would ask you to direct
11 specifically that question to Mr. Schooley. He did
12 provide an analysis. But again, the analysis that he
13 gave were based on projections of deferral balances in
14 relationship to deferred power supply costs. And as I
15 have stated, that the Commission in determining what is
16 appropriate interim relief standards has never relied on
17 long-term projections, projections out until 2003, for
18 determining what's an appropriate amount of interim
19 relief under its traditional interim relief standards.

20 JUDGE MOSS: Mr. Elgin, that did go
21 considerably beyond the question, so I will ask you to
22 try to just focus on the questions, or we may have a
23 very long day.

24 THE WITNESS: Okay.

25 BY MR. MEYER:

00571

1 Q. Mr. Elgin --
2 CHAIRWOMAN SHOWALTER: I'm just going to add
3 further as someone who asks questions, shorter answers
4 really are better, because it allows the questioner to
5 keep the train of thought going. And if you get a
6 really long answer, it might be interesting, but what it
7 means is by the time the answer is finished, the
8 questioner may have lost where he or she was going.
9 MR. MEYER: Thank you.
10 BY MR. MEYER:
11 Q. Mr. Elgin, you did review, of course,
12 Mr. Schooley's testimony in this case?
13 A. Yes.
14 Q. I'm going to read to you an excerpt from page
15 18 of his testimony. Turn to it if you like. It begins
16 at line 3. Are you with me?
17 A. Page 18?
18 Q. Page 18, Mr. Schooley, beginning at line 3.
19 JUDGE MOSS: And for the record, that's
20 Exhibit 401.
21 MR. MEYER: Thank you.
22 BY MR. MEYER:
23 Q. It reads:
24 Avista's evidence shows a serious
25 decline by the third quarter of this

00572

1 year with negative cash flow and an
2 inability to cover its fixed interest
3 charges. The trend improves over the
4 next several quarters but not to the
5 point of meeting the fixed charge
6 coverages required.

7 Have I read that accurately?

8 A. You have read it accurately.

9 Q. Okay.

10 A. In response to the question, what data does
11 Avista present to meet those covenants.

12 Q. Based on your understanding or your reading
13 of Mr. Schooley's testimony, does that suggest that a 90
14 day surcharge if allowed to expire would assist the
15 company in meeting its fixed interest charge coverages
16 over the next several quarters?

17 A. If it were allowed to -- if it expired, it
18 would not, assuming that all the projections came to
19 fruition under the company's assumption in its
20 presentation.

21 Q. Okay, let's turn to another area. Were you
22 present yesterday throughout the day?

23 A. Yes.

24 Q. Good. Can you testify, Mr. Elgin, as a
25 member of the Staff and with any degree of assurance

00573

1 that Staff's recommendations, if adopted, would not
2 contribute to a downgrade of Avista's credit rating?

3 A. I believe that what the Staff is attempting
4 to do is provide the revenues necessary for the company
5 to finance on reasonable terms, so I believe was what
6 the analysis Mr. Schooley provided.

7 Q. Sorry, the question --

8 A. I can not guess what S&P or Moody's or Fitch
9 would do based on Staff's recommendation. I have no
10 knowledge. I can't testify to that.

11 Q. So am I to infer, Mr. Elgin, that if you can
12 not testify to that, then you are not in the position to
13 provide any degree of assurance to this Commission that
14 the Staff's recommendations if adopted would not lead to
15 a credit downgrade for the company, correct; doesn't
16 that follow, Mr. Elgin?

17 A. Mr. Meyer, I testified that I don't know what
18 S&P or Moody's or Fitch would do. What the Staff is
19 attempting to do is provide a sufficient amount of money
20 in the interim to carry over to a general rate case so
21 that we can evaluate that and so the company can finance
22 the utility operations on reasonable terms and
23 conditions and meet its public service obligations.
24 That's what Staff attempted to do.

25 MR. MEYER: Your Honor, that question put now

00574

1 twice allows for a yes or no answer. Explanation is
2 fine, but it allows for a yes or a no answer.

3 JUDGE MOSS: I think he gave the answer that
4 he doesn't know.

5 MR. MEYER: Doesn't know, okay.

6 MR. TROTTER: Excuse me, Your Honor. I must
7 object to that. The question was, will S&P or Moody's
8 downgrade, and Mr. Elgin correctly said that essentially
9 that's up to them.

10 MR. MEYER: No, that's not the question.

11 JUDGE MOSS: All right, let's stop. The
12 question is whether the witness can give any reasonable
13 assurances, and I believe his answer was that he had no
14 way of knowing what they would or not would do, which is
15 tantamount in my mind to saying he can't give such
16 assurances. The answer is no, all right, so let's move
17 on.

18 MR. MEYER: Thank you.

19 BY MR. MEYER:

20 Q. I'm going to frame the next question, and I
21 will try and do this quickly, in more or less the same
22 manner.

23 Can the Commission Staff provide any
24 reasonable degree of assurance to this Commission that
25 if its recommendations are adopted that it will not

00575

1 impair, not impair Avista's ability to draw on its lines
2 of credit?

3 A. Again, I believe that under the Staff
4 recommendation, when the company's provided the
5 surcharge, makes the filings, and we get to a resolution
6 of the Phase II proceeding, that the company should be
7 able to borrow under its lines of credits. I also would
8 note that the testimony from -- that I heard yesterday
9 from Mr. Peterson said that the company should be able
10 to finance through the end of 2001. So I think the
11 Staff recommendation gets us there, to finance, in other
12 words, lines of credit.

13 Q. And do you know, Mr. Elgin, whether with what
14 Staff recommends, if adopted, that the company would be
15 able to issue additional common stock?

16 A. I believe that the company could issue
17 additional common stock.

18 Q. And where is the analysis set forth in your
19 testimony or that of other Staff witnesses to support
20 such an assertion?

21 A. I don't have any, and I don't believe the
22 Staff has presented any.

23 Q. Okay, next question. Do you believe that if
24 your recommendations were adopted by this Commission
25 that the company would be able to complete the financing

00576

1 of Coyote Springs II?

2 A. I think the financing of Coyote Springs II
3 would be somewhat contingent upon resolution of the
4 Phase II proceeding and what would ultimately be
5 recovered in rates from the deferred accounting. There
6 is a significant issue still surrounding what the
7 company has put on its books, and the financial
8 community has some concern. Once that issue is
9 resolved, in other words, what is properly recoverable
10 in rates and the financial community has some assurance
11 about those level of revenues and we move forward, I
12 think the company shall -- would be able to finance
13 Coyote Springs II.

14 JUDGE MOSS: I'm going to stop here, because
15 I'm losing track of things. Your question, as I
16 understood it, Mr. Meyer, related to the Staff's
17 recommendations in this phase in the proceeding and not
18 to some subsequent phase or some other proceeding; is
19 that right?

20 MR. MEYER: That is correct.

21 JUDGE MOSS: Mr. Elgin, the question to you
22 was in the context only of this phase of the proceeding.
23 And perhaps you can restate the question
24 better than I.

25 MR. MEYER: Yes.

00577

1 JUDGE MOSS: Would you do that, please.

2 MR. MEYER: Gladly.

3 BY MR. MEYER:

4 Q. Mr. Elgin, if the Commission were to adopt
5 your recommendations in this proceeding as part of the
6 order that issues in this proceeding, can you state with
7 any degree of assurance that the company would be able
8 to fund or finance the construction of Coyote Springs
9 II?

10 A. Yes, I believe the company would be able to
11 finance Coyote Springs II if the Staff recommendation is
12 adopted.

13 Q. Where is the analysis set forth in your
14 testimony or that of other Staff witnesses?

15 A. I would direct you to the testimony of
16 Mr. Schooley and his analysis regarding the level of
17 rate relief that's necessary to meet interim financing
18 standards so the company may be able to finance.

19 Q. I would like to do that. I would like to
20 direct you there. Page 20 of Mr. Schooley's testimony,
21 beginning at line 1, let me know when you're there.

22 A. Which line?

23 Q. Beginning at line 1. It reads in part:
24 In the calculation, I assume Avista is
25 able to finance Coyote Springs II plant

00578

1 and that Avista successfully issues
2 \$67,600,000 of common stock in the
3 remainder of 2001. With those
4 adjustments, with those adjustments, my
5 calculation indicates a need for
6 \$19,000,483 in the fourth quarter of
7 2001. This is an increase of 32.6% over
8 current revenues.

9 Have I read that excerpt correctly?

10 A. Yes.

11 Q. Okay. So the Staff recommendation of a 32.6%
12 increase assumes, does it not, according to
13 Mr. Schooley's testimony, that Avista is otherwise able
14 to finance Coyote Springs II and is otherwise able to
15 issue common stock, correct?

16 A. Yes.

17 Q. Thank you. Mr. Elgin, let's assume that
18 things don't work out quite as planned, and let's assume
19 that for whatever reason, whether because of Staff's
20 recommendations or otherwise, Avista's credit ratings
21 are downgraded to speculative grade. Are you with me so
22 far on the assumptions?

23 A. Yes.

24 Q. Okay. If that were to occur and if that were
25 to occur at least in part because of what Staff

00579

1 recommended, would raising rates by 32.6%, which is
2 Staff's recommendation, have accomplished its intended
3 purpose?

4 A. Well, the intent and purpose is to get the
5 company to a point where we can determine the prudence
6 of the power costs incurred and get to a general rate
7 case where we can analyze the company's full operations,
8 including the acquisition of Coyote Springs II, and to
9 assess its needs for emergency rate relief, and to
10 provide the company a reasonable opportunity to manage
11 its way through and to get to resolution of the issues
12 that are clouding this company's financial picture, and
13 that is the deferred power supply expenses on its books
14 that are heretofore unrecovered.

15 Q. Mr. Elgin, in order to get to the resolution
16 of those issues, as you have described them, in the
17 course of the next general rate case or in the course of
18 a Phase II proceeding, is it your belief that the
19 company would need to maintain in the meantime its
20 existing credit rating?

21 A. In the interest of rate payers for obtaining
22 and maintaining at least an investment grade bond
23 rating, that is in the rate payers' interest and the
24 company's interest.

25 MR. MEYER: Thank you, that's all I have.

00580

1 JUDGE MOSS: Thank you.

2 Mr. Van Cleve, do you have anything for

3 Mr. Elgin?

4 MR. VAN CLEVE: I have a couple of questions,
5 Your Honor.

6

7 C R O S S - E X A M I N A T I O N

8 BY MR. VAN CLEVE:

9 Q. Mr. Elgin, could you refer to page 9 of your
10 testimony, and at lines 14 through 20, there's a number
11 of standards set out. Is it the Staff's position that
12 these standards must be satisfied by the company before
13 any of the deferral balance is recovered?

14 A. That's correct.

15 Q. And to your knowledge, have any of these
16 standards been satisfied?

17 A. No.

18 Q. Can you tell me what your understanding of
19 Standard C is, the appropriateness of recovery of power
20 cost through a deferral mechanism?

21 A. My understanding of that requirement is the
22 determination of whether or not deferred accounting for
23 power supply expenses is reasonable at all. In other
24 words, should the company have a mechanism, it's
25 analogous to the question that the Commission addressed

00581

1 in Avista's last general rate proceeding, is a PCA
2 appropriate, and in this context it is, is a deferred
3 accounting mechanism for these types of costs and
4 recovery from rate payers appropriate.

5 JUDGE MOSS: While Mr. Van Cleve organizes
6 his notes, are you equating there the deferral mechanism
7 to a PCA mechanism, or are you talking about two
8 different things?

9 THE WITNESS: I'm saying it's the same
10 normative question, should one exist, and is it
11 appropriate to recover those through that mechanism.

12 JUDGE MOSS: Thank you.

13 BY MR. VAN CLEVE:

14 Q. And is it your position that that's an
15 unresolved issue in this case?

16 A. Yes, it is, it's a condition -- it's a
17 requirement of the Commission. The Commission wants
18 that question answered before it will provide for
19 recovery is my understanding of their orders.

20 Q. And do you know in line 19 on page 9 what the
21 standard is that refers to mitigation of power costs?
22 Do you know what kind of mitigation is contemplated
23 there?

24 A. I can speak to that, because I have reviewed
25 the company's initial filing in the March phase of this

00582

1 proceeding when the company submitted testimony and
2 exhibits to address these issues, and this is an
3 analysis and evidence that the company actually has on a
4 going forward basis a plan to make sure that any future
5 costs that it incurs are reasonable and the minimum
6 necessary in order to provide service.

7 Q. If you could refer to page 16 of your
8 testimony, and in the second line, you use the phrase,
9 given brain shock customers will experience under rate
10 request in the magnitude of 37%; do you see that?

11 A. Yes.

12 Q. And also I just would point out that at page
13 21, lines 8, you say, the Commission should also
14 consider that a 37% rate increase constitutes rate
15 shock. Can you define rate shock as you're using it in
16 those two instances?

17 A. Yes. Rate shock is just simply the change in
18 rates that customers pay for any utility service as a
19 result of a filing to change those rates. In other
20 words, company makes a general rate filing and a -- it
21 requests a 3% or a 10% or in this instance approximately
22 a 39% increase in rates. That's a change in the rates,
23 and rate shock is the relative difference between the
24 existing rate levels and the rate level that the utility
25 requests by the tariff filing.

00583

1 Q. Do you believe that rate shock is something
2 that the Commission has a duty to try to mitigate?

3 A. Yes, I do.

4 Q. And given your experience at the Commission,
5 how does this rate increase compare with rate increases
6 that you have seen in the past from electric utilities
7 in this state?

8 A. My experience with an increase of this
9 magnitude goes back to when many of the electric
10 company's were putting in major new thermal plants, and
11 at the same time many other utilities were putting in
12 large central station nuclear power plants. One of the
13 big issues was precisely rate shock and how to manage
14 those increases so that you did not have 40% increases.
15 You would do creative things like defer and phase in the
16 increases, and you do many things to ratably ratchet up
17 the rates so that the customers do not see a major
18 change in rates from one period to the next.

19 Q. And were you here this morning when
20 Mr. Hirschhorn testified that the Schedule 25 industrial
21 customers would experience a 55% rate increase under an
22 equal cents per kilowatt hour allocation of the
23 surcharge?

24 A. Yes.

25 Q. And are you aware that there has ever been a

00584

1 rate increase that large for an electric utility in this
2 state for any particular customer class?

3 A. Yes, there has been.

4 Q. And when was that?

5 A. The Schedule 48 customers over a period of
6 time when the Mid-Columbia Index ratcheted up, those
7 customers had experienced those types of rate increases.
8 But for general tariff service that would not use
9 indexed pricing, I'm not aware of any increase of that
10 magnitude.

11 Q. Would you agree that the rate shock in this
12 case is somewhat exacerbated by the fact that there was
13 a settlement entered into and that was approved by the
14 Commission in May under which the company was projecting
15 that it wouldn't increase rates until sometime in 2003?

16 A. I believe that's a factor that contributed to
17 the position that the company finds itself in today and
18 the requests that it's seeking to impose.

19 Q. But do you think that in analyzing the rate
20 shock issue, the Commission should consider the lack of
21 notice that this type of increase might be coming?

22 A. Well, that is a concern, and I think that
23 that's one of the reasons why Staff was in a very
24 difficult position with crafting its recommendation
25 regarding the increase and how we proceed and get to a

00585

1 general rate case so that we can better manage that and
2 have the public's involved and informed and
3 participating and a general rate case so that we can get
4 to these issues.

5 Q. Would you agree that the BPA settlement
6 credit will somewhat lessen the rate shock for the
7 residential customer class?

8 A. Yes, it does.

9 Q. Can you explain why the Staff is not
10 supporting the accelerated amortization of the PGE
11 credit?

12 A. I would direct that question to Mr. Schooley
13 or Mr. Parvinen.

14 Q. I would like you to refer to page 16 of your
15 testimony, and at lines 7 through 23, you cite a couple
16 of cases in which the Commission has rejected surcharge
17 requests in the past; is that correct?

18 A. Yes.

19 Q. And do you believe that the request in this
20 case is consistent with those cases?

21 A. Yes.

22 MR. MEYER: I object, tends to -- withdraw
23 the objection, go ahead see where this goes.

24 JUDGE MOSS: Go ahead, Mr. Van Cleve.

25 BY MR. VAN CLEVE:

00586

1 Q. And why is it consistent?

2 A. It's consistent in the sense that you're
3 looking at one single item in the utility's cost of
4 service, as I testified in elsewhere. We're looking at
5 one element of this company's cost of service, and
6 that's power supply costs. And why I identified these
7 two cases had to do specifically with the Commission
8 looking at Kettle Falls in 8326 for Avista and some
9 extraordinary expenses for Washington Natural Gas in
10 U-81-11, and the Commission said these are not
11 appropriate vehicles for looking at emergency rate
12 relief, a single issue. It was in the utility's cost of
13 service.

14 Q. So how is it that the company's request in
15 this case is consistent with that precedent?

16 A. Well --

17 Q. I mean I guess looking at the next question
18 on page 17 where you start the question, assuming that
19 the request for surcharge is not rejected is
20 inconsistent with those cases, is there some reason to
21 believe, do you have a reason to believe that the
22 request should be rejected because it's inconsistent
23 with those decisions?

24 A. What we tried to do is provide -- the Staff
25 recommendation is a bridge, and what we're trying to do

00587

1 is say we don't think that the surcharge request should
2 be processed under the interim standards, but should you
3 apply them, how much should the company get on a
4 short-term basis to bridge us to a point where we can
5 evaluate the company's -- an interim request in the
6 context of a general rate case, so that's what the Staff
7 attempted to do.

8 Q. So what standard do you think that the
9 surcharge request should be processed under?

10 A. I think that it should be processed under the
11 Commission's standard to broadly regulate in the public
12 interest and provide sufficient revenues for a company
13 to solve its problem related to the power supply issues
14 that are on its balance sheet and get to a general rate
15 case to where we have the company's operations in front
16 of us to make a full evaluation of its expenses and rate
17 base, and fix permanent rates at the end of that case,
18 so that it's under the broad rate making authority to
19 regulate in the public interest.

20 Q. Given the potential for rate shock that you
21 have identified, do you believe that the Commission
22 should require the company to pursue alternatives such
23 as the ones mentioned yesterday like the sale of Coyote
24 Springs II, the sale of unregulated subsidiaries,
25 reductions in capital budgets, things like that?

00588

1 A. I believe that those are things that I don't
2 have enough evidence, and in this short period of time,
3 the Staff did not have enough evidence to evaluate them
4 fully. So in the context of the narrow time we had to
5 process this request and not having all the information
6 in front of us, this is what -- those are options that
7 we can consider going forward.

8 Q. Are you familiar at all with the operations
9 of Avista's unregulated subsidiaries?

10 A. Not specifically, only broadly.

11 Q. Do you personally have an opinion as to
12 whether Avista's unregulated operations have contributed
13 to the company's current financial situation?

14 A. Yes, I believe that there's a significant
15 issue regarding the company's --

16 MR. MEYER: Excuse me, I object.

17 JUDGE MOSS: Try to interpose your objections
18 before the witness answers. I think he did pause
19 adequately that time, but go ahead.

20 MR. MEYER: Really on two bases. First of
21 all, this is in the nature of friendly cross. Secondly,
22 the cross doesn't relate directly to a specific
23 recommendation inherent in Mr. Elgin's testimony.

24 JUDGE MOSS: All right, as to the first part
25 of the objection, to what does this relate?

00589

1 MR. VAN CLEVE: Well, I think it relates to
2 the overall recommendation in the case, Your Honor, and
3 what the impact of -- the effect of the unregulated
4 operations on the Staff's proposal.

5 JUDGE MOSS: Let me --

6 MR. VAN CLEVE: Should it have any impact.

7 JUDGE MOSS: Let me put the question a little
8 more directly. In what way is this witness's
9 recommendations through his testimony adverse to your
10 position in the case?

11 MR. VAN CLEVE: Well, our initial position is
12 that there shouldn't be any surcharge, and his position
13 is supporting the surcharge.

14 JUDGE MOSS: All right, go ahead, restate
15 your question.

16 MR. VAN CLEVE: Well, let me ask it this way.

17 BY MR. VAN CLEVE:

18 Q. If the Commission concludes that Avista's
19 unregulated operations have significantly contributed to
20 the company's current financial situation, would that
21 impact your recommendation at all?

22 A. Yes.

23 Q. And --

24 A. And I expect that analysis to be part of what
25 we would get to in the general rate case, the ongoing

00590

1 level of relief for the company.

2 JUDGE MOSS: But I think his question was
3 whether it would impact your recommendation in this
4 phase rather than your --

5 THE WITNESS: Oh, excuse me, I misunderstood
6 the question.

7 JUDGE MOSS: Maybe I misunderstood the
8 question.

9 MR. VAN CLEVE: No, that was the question.
10 BY MR. VAN CLEVE:

11 Q. There was a hypothetical posed earlier
12 today --

13 JUDGE MOSS: Well, let's get the answer to
14 this first. The question was whether the company's
15 activities with respect to its unregulated subsidiaries
16 would impact the Staff's proposal in this phase for 32
17 some odd percent.

18 A. No, it would not, not in this phase, if I
19 understand that question.

20 Q. So let me try to ask you what I think was a
21 hypothetical earlier today from the Chairwoman, and that
22 was that if the adverse financial situation was entirely
23 a result of unregulated operations, should the company
24 still be granted interim rate relief?

25 A. No, it should not.

00591

1 MR. VAN CLEVE: That's all I have, Your
2 Honor.

3

4

E X A M I N A T I O N

5 BY JUDGE MOSS:

6 Q. Okay. Mr. Elgin, I want to be sure that we
7 have a clear record here, and thinking about that last
8 question and answer, I'm concerned that Mr. Van Cleve's
9 question used the term interim rate relief, and I have
10 understood you to be using that term very carefully and
11 that you were using that term in connection with what
12 the Commission would consider in Phase II of this
13 proceeding following your proposal for a 90 day
14 surcharge that would be a stopgap measure to get us to
15 the point where we could consider the appropriateness of
16 INTERIM RATES, all caps, under the standards of the
17 Pacific Northwest Bell proceeding.

18 A. I would agree with everything you said, but
19 it would not be in Phase II, Your Honor. Phase II would
20 be limited exclusively to the question of prudence and,
21 you know, as Mr. Ely said, as a catch all phrase, all
22 the issues identified in the accounting orders that set
23 up the deferred accounting, the prudence, the
24 appropriateness of the deferral mechanism, the level of
25 recovery, that's limited to Phase II. The interim as I

00592

1 use the term interim, that has to do with applying those
2 standards in the general rate case.

3 Q. All right. And you would call the 32%
4 stopgap measure a surcharge or something other than
5 interim rate?

6 A. That's correct.

7 JUDGE MOSS: Now with that understanding,
8 Mr. Van Cleve, did you get -- do you believe your
9 question was understood and responded to accurately?
10 Well, you don't know about the response, but do you
11 believe your question was taken correctly?

12 MR. VAN CLEVE: Could I ask one more
13 question?

14 JUDGE MOSS: I think you might want to do
15 that.

16

17 C R O S S - E X A M I N A T I O N

18 BY MR. VAN CLEVE:

19 Q. If the Commission were to conclude, this is a
20 hypothetical again, if the Commission were to conclude
21 that the company's current financial situation was
22 entirely due to the unregulated subsidiaries, would a
23 surcharge as proposed by Staff still be appropriate?

24 A. No, in this -- if -- based on the evidence
25 that Mr. Thornton provided and if the Commission on the

00593

1 basis of that concluded that all the problems of Avista
2 today are as a result of the unregulated operations, in
3 that hypothetical, then I don't believe the Commission
4 should grant the increase, if that's your -- if I
5 understand your hypothetical.

6 MR. VAN CLEVE: Right, thank you.

7 JUDGE MOSS: All right, I think the record is
8 now clear on the point, thank you.

9 With that, I believe we are ready for any
10 questions that you might have, Mr. ffitch.

11 MR. FFITCH: Thank you, Your Honor.

12

13 C R O S S - E X A M I N A T I O N

14 BY MR. FFITCH:

15 Q. Good afternoon, Mr. Elgin.

16 A. Good afternoon, Mr. ffitch.

17 Q. Let me first follow up on the questions
18 regarding rate shock. Let me ask you if in your opinion
19 the Staff's proposal for a 32.6% surcharge would
20 constitute rate shock under your definition?

21 A. Unfortunately it does, yes.

22 Q. And has the Staff made any proposal in its
23 testimony for mitigation of that rate shock to the
24 Commission?

25 A. No.

00594

1 Q. Do you have any proposal to make based on
2 your experience with past rate increases, any
3 recommendations that you might make on the stand today
4 of the kinds of tools that are available to the
5 Commission to mitigate rate shock?

6 A. I can think of several that would be at the
7 Commission's disposal. One could be to go to the
8 company's original accounting petition and do a ten year
9 amortization. That's what the company originally asked
10 for, and that's one option.

11 The other could be, and as I understand the
12 company's direct case, the issue is uncertainty in Wall
13 Street. So if the Commission felt that, for example,
14 Mr. Schoenbeck's testimony about the 95% probability of
15 a certain level of recovery is appropriate, you can fix
16 that and then create a regulatory asset, and you could
17 then say, this is how we would like it recovered. And
18 you can provide a deferred return on that, and you can
19 -- with certainty. That would be on the balance sheet,
20 that would be clearly a regulatory asset, and the
21 company can go to Wall Street with some assurance that
22 that's going to be recoverable.

23 Another option would be, quite frankly, if
24 the Commission determined that none of these costs are
25 appropriate. If we get to some certainty. What Wall

00595

1 Street and what I hear the company saying is that
2 there's risk, there's this uncertainty, and the
3 uncertainty was caused by the magnitude of the growth of
4 these costs on the company's balance sheet. And so what
5 the company is saying is we need to get to resolution of
6 this. If it turns out that those costs are
7 inappropriate for rate recovery and rate payers
8 shouldn't pay for them, we need to get that issue
9 decided. And once that issue is decided, that's final,
10 there's some finality there, and that Wall Street knows
11 what the prospects of the company are. But what's
12 before you today is uncertainty, so to the extent that
13 you want to mitigate those increases and provide
14 certainty with respect to this company's financial
15 results, I think that goes -- those two things go hand
16 in hand.

17 Q. Now Mr. Van Cleve asked you about the use of
18 other alternatives to mitigate the rate shock, if you
19 will. I think he read through a list of items that had
20 to do with, for example, Coyote Springs or stock
21 dividend cancellation, that sort of thing. And you
22 indicated that you and Staff had not considered those,
23 correct?

24 A. We considered them, but we did not make a
25 recommendation. We just did not have enough time to get

00596

1 to a point where we had a recommendation that we were
2 comfortable with.

3 Q. But my question is, there has been testimony
4 about those alternatives in this hearing, has there not?

5 A. Yes, there has.

6 Q. And in your opinion, should the Commission
7 consider those alternatives as available to it in this
8 case in making its decision as part of a mitigation
9 strategy for any rate shock problem?

10 A. There are some of the -- some of the
11 proposals that I -- I'm extremely uncomfortable with and
12 some preliminary discussions I have had with other
13 members of Staff who aren't uncomfortable. First off, I
14 don't think it's appropriate for the Commission to tell
15 the company to cut its dividend. That's a board
16 decision, and that's something up to the board and
17 between the board and the shareholders and their
18 covenants. I'm uncomfortable with accelerated
19 depreciation. I had -- I have seen the impacts of using
20 deferred ITC to --

21 CHAIRWOMAN SHOWALTER: What is ITC?

22 A. Investment tax credits. I have had the
23 experience where this company and Puget Sound Power and
24 Light used those deferred tax credits for mitigating
25 rate shock. I'm uncomfortable with those. I believe

00597

1 that those are kind of long-term things that belong
2 within the cost of service over the useful life of the
3 assets.

4 I do think that I'm uncomfortable with the
5 Commission directing the company to do certain things
6 that are in -- within the decision of management and
7 management's prerogative in general, and a lot of the
8 suggestions that I have heard from the other parties get
9 to that very point. I think that the company needs to
10 make those decisions and manage its business, and if it
11 turns out that some of those decisions were not in the
12 best interest or were imprudent, then it's up to the
13 Commission to say those were inappropriate costs for
14 rate payers, and if the chips fall where they may and it
15 turns out that bankruptcy is the consequence, then we
16 have to go that route. But those are decisions that the
17 management makes, and the Commission makes judgments
18 about those, and it's not unprecedented that utilities
19 have gone bankrupt.

20 Q. Well, first of all, isn't it the case though
21 that both the company and the Commission have an
22 obligation to explore all of the alternatives for
23 dealing with the financial situation, not just
24 increasing customer rates, but looking at all of the
25 alternatives they have available; isn't that correct?

00598

1 A. That's correct, and that's why Staff wants a
2 general rate case, so that we can look at all those
3 decisions. I mean we just have not had enough time to
4 look at all the things that are within the purview of
5 management and what decisions they are making during
6 this time of financial crisis. We just don't have
7 enough information.

8 Q. But the results of that lack of information
9 on your part and the results of the company's choice of
10 solution here has very real and direct impacts,
11 including rate shock, on the customers and the
12 communities of Eastern Washington, doesn't it?

13 A. Yes, yes, it does.

14 Q. So why can we not -- why can not the
15 Commission at this time and why should not the
16 Commission at this time evaluate the alternatives now
17 rather than three months from now or six months from now
18 or nine months from now? I guess, you know, to maybe
19 restate the question a little more in a summary form.
20 In your opinion, should the Commission consider those
21 other alternatives as part of its decision at this stage
22 of the case? And I will accept that you have weighed in
23 with a certain position of your own on the advisability
24 of some of those options, and I understand that, and I
25 accept that. But what I'm asking you is, should not the

00599

1 Commission take those alternatives into consideration in
2 making its decision at this juncture?

3 A. No, because many of the alternatives, my
4 impression of them are, to use the phrase, they are
5 thinking off the top of the hat. They're not well
6 thought out. We don't know what the long-term
7 consequences of those decisions will be, and I would
8 think that we are not in a point where the Commission
9 should make those kinds of judgments based on limited
10 knowledge.

11 Q. You indicated that one of the difficulties
12 with some of these alternatives is interference with
13 management prerogative. It's true, isn't it, that if
14 the Commission were to order a smaller surcharge amount
15 for the company, that would require the company then to
16 seek its cash or its financial needs in other fashions,
17 and then the company would be left to its own management
18 and discretion about how to raise those other funds;
19 isn't that correct?

20 A. That is correct. In other words, I agree
21 with you that if it turns out that the Commission felt
22 that 40% was too much and 20% or Mr. Schoenbeck's
23 recommendation and the company had a fixed amount of
24 money and knew what was the prospects, it would take
25 other action. And some of those actions may be very

00600

1 well what the other parties have recommended. That may
2 very well be.

3 Q. Pardon me for a minute while I sort my notes
4 here.

5 Can I ask you to turn to page 16 of your
6 testimony, which is Exhibit 451-T, at line 18, and there
7 you discuss an earlier Avista case, Docket U-83-26. Was
8 that during the nuclear construction era when Water
9 Power had investments in WNP-III and Skagit, nuclear
10 facilities which had not yet been ruled on by the
11 Commission?

12 A. Yes.

13 Q. And that nuclear investment was of the same
14 order of magnitude as this deferral, was it not, around
15 \$200 Million?

16 A. For both projects together, I think it was
17 \$170 Million for WNP-III, its 5% interest in that
18 project, and approximately was it \$40 Million for the
19 other nuclear facility.

20 Q. And Water Power was about an \$800 Million
21 company at that time; is that right, subject to check?

22 A. Would that be electric only?

23 Q. Total company.

24 A. Yeah, I think \$800 Million sounds about right
25 for total gas and electric operations at that time. It

00601

1 was about a \$600 Million electric company.

2 Q. Do you have an opinion as to which would be a
3 greater concern to the financial community, and I will
4 give you two alternatives here, a \$200 Million
5 investment in what I will call dead nucs, and an \$800
6 Million company bought Water Power at that time, that's
7 option one, or two, a \$200 Million power cost in a \$1
8 1/2 Billion dollar company, Avista today?

9 A. Well, if I was a financial analyst and
10 looking at the prospects of those two investments on the
11 company, the former is definitely more significant,
12 because it's a capitalized amount, and it's rate based,
13 and it's a much smaller company at the time.

14 Q. That would be of greater concern to you as a
15 hypothetical financial community member?

16 A. Well, yes, and it was a greater concern to
17 the Commission in terms of how do we deal with the
18 abandoned nuclear projects at the time. I mean it was a
19 big issue.

20 Q. And yet at that time, the WUTC denied any
21 form of interim rate relief; is that correct?

22 A. It denied -- in 8316, my testimony here
23 stands for the proposition that it denied interim rate
24 relief for specific inclusion and costs associated with
25 Kettle Falls.

00602

1 Q. But they didn't give it for any other reason
2 either in that case?

3 A. No.

4 Q. Did you or any other member of Staff compare
5 the company's current financial indicators to those in
6 1983 when the Commission denied interim rate relief in
7 that case?

8 A. I did not look at the specific financial
9 indexes at the time, but I do -- I do recall though I
10 believe I heard testimony from Mr. Eliassen yesterday
11 that at this time the company was able to issue common
12 stock, or I think that was the last time a public
13 offering of its common equity was made, around that time
14 frame.

15 MR. FFITCH: May I have one moment, please,
16 Your Honor?

17 JUDGE MOSS: Yes, you may.

18 BY MR. FFITCH:

19 Q. Are you generally familiar with the history
20 of previous Washington Water Power rate increases?

21 A. Yes.

22 Q. And would you accept subject to check that
23 the largest every was in U-83-26 of \$32 Million?

24 A. I have those figures with me if you would
25 give me a second.

00603

1 Yes.

2 Q. Can I ask you to turn to page 20 of your
3 testimony.

4 JUDGE MOSS: Mr. ffitch, are you starting a
5 new line?

6 MR. FFITCH: I am, Your Honor.

7 JUDGE MOSS: And how much do you anticipate
8 that you have?

9 MR. FFITCH: I just have three or four
10 questions, and then I believe I am finished.

11 JUDGE MOSS: All right, I can let you go
12 until 3:30, but we need to take a break at that moment,
13 so if you're not finished, then I'm going to interrupt
14 you.

15 MR. FFITCH: Okay, I think I can do this in
16 that time frame.

17 BY MR. FFITCH:

18 Q. On page 20, you state that Avista has not
19 demonstrated that all elements of its ongoing
20 construction budget are necessary for it to carry out
21 its obligation as a public service company.

22 A. Yes.

23 Q. And have you reviewed Avista's 2001 budget,
24 which has been made an exhibit in this case?

25 A. No, I have not.

00604

1 Q. Has the Staff rendered an opinion -- well,
2 let me, since you haven't, let me just ask you subject
3 to check that the budget contains a list of construction
4 and capital projects, does it not?

5 A. Yes, it would.

6 Q. And has the Staff rendered an opinion as to
7 whether the capital items in that budget are necessary
8 for Avista to carry out its obligations as a public
9 service company?

10 A. No, it hasn't.

11 Q. Has Staff investigated that question?

12 A. No.

13 Q. In your experience, have companies sometimes
14 delayed or deferred or canceled capital projects when
15 they're under financial stress?

16 A. Yes.

17 Q. To your knowledge, has Avista submitted any
18 amendments to its 2001 budget reflecting any deferral,
19 delay, or cancellation of any capital projects?

20 A. No, I don't know whether it has or not.

21 Q. Do you know if it has otherwise advised the
22 Commission of any such amendments outside of a formal
23 budget amendment process?

24 A. No.

25 Q. Any other such deferrals, excuse me, or

00605

1 delays or cancellations?

2 A. The only information that I had is the
3 testimony that we all heard yesterday from Mr. Ely
4 regarding what the company has regarding to a couple of
5 projects.

6 MR. FFITCH: Your Honor, those are all the
7 questions I have. I guess just with the caveat that if
8 we can just knock off, I might just check my notes
9 during the break if I have one more. I don't think I
10 do, but my notes are rather cluttered, so.

11 JUDGE MOSS: I will give you the caveat in
12 the interest of time.

13 We will take our recess until 3:45.

14 (Recess taken.)

15 JUDGE MOSS: Mr. Meyer, you have raised the
16 or re-raised the issue of the possibility of the company
17 wishing to put on some additional rebuttal in this
18 proceeding through having Mr. Eliassen recalled to the
19 stand briefly. And while I indicated at the outset that
20 that is an option I would not foreclose, it is not an
21 option I foreclose now either, but I wish to hear if
22 other counsel have any thoughts on the possibility or
23 the prospect of that occurring?

24 MR. VAN CLEVE: Your Honor, can we maybe get
25 some more specificity about what exactly the rebuttal

00606

1 would be responding to, for instance, what witnesses?

2 MR. MEYER: Thus far, it would be responding
3 to statements made by Schoenbeck, Thornton, and Elgin.
4 Again it will be fairly quick, it will be to the point,
5 and I think unless it expands based on further
6 discussion here about ten minutes.

7 MR. TROTTER: Can we have it in advance?

8 MR. MEYER: No, because we don't have it
9 prepared in advance.

10 JUDGE MOSS: Well, it sounds like it would be
11 a sufficiently brief presentation that counsel would be
12 able to respond to it. And if there was a difficulty in
13 that regard or a need for some additional documentary
14 evidence in support of cross-examination, then we could
15 take that up at the time and consider whether we might
16 need to make some special arrangement for that. But in
17 general, I think the suggestion is probably one that
18 would lend efficiency and perhaps produce a more
19 complete record that we might need. So let's
20 tentatively plan that we will allow for that, and
21 counsel can let me know if it poses any particular
22 difficulty for them at the time, and we will deal with
23 it appropriately.

24 Now in terms of the remaining witnesses, of
25 course, we still have Mr. Elgin on the stand, and then

00607

1 we have three more Staff witnesses. It's approaching
2 4:00 in the afternoon. We are prepared to go over a
3 bit, as we did yesterday, and the Commission's interest
4 is -- paramount interest is in having a full and
5 complete record for a decision, and so I wouldn't want
6 anybody cutting off cross-examination that they thought
7 was necessary to the development of the record. Yet at
8 the same time, I would, as I always do, encourage you to
9 hone your questions down to a few finely tuned and
10 pointed inquiries.

11 So with all that, let us proceed, and I think
12 we were at the stage where we were ready for questions
13 from the Bench.

14 MR. FFITCH: Your Honor, I had completed my
15 finely tuned question, and if I may before we proceed, I
16 just wanted to apologize to the witness, Mr. Elgin, if I
17 was intemperate in my questioning while he was on the
18 stand.

19 JUDGE MOSS: Thank you.

20 CHAIRWOMAN SHOWALTER: Mr. Elgin, my
21 questions might not be finely tuned, I'm going to say.

22 JUDGE MOSS: I may have to object.
23
24
25

00608

1 E X A M I N A T I O N

2 BY CHAIRWOMAN SHOWALTER:

3 Q. And because I am taking -- took notes on both
4 your questioning here but also your written testimony,
5 it might come back around to the same subject. But
6 beginning with your testimony here, first regarding
7 Phase II issues, I understand what those issues are and
8 why we set them out as needing to be addressed at some
9 stage. If a general rate case is filed, would you think
10 it would be natural and appropriate to incorporate those
11 issues into the general rate case, or did I understand
12 you to think they are quite separate?

13 A. I think they are quite separate and deep,
14 they are quite separate, Madam Chairwoman. The Phase II
15 has to do with past costs, what is on the company's
16 books, what has been deferred. The general rate case is
17 a proceeding where we look at a test period when we
18 restate the test period, normalized, look forward and
19 put forward to the rate year, and adjust rates
20 perspectively. So in my mind, they're separate and
21 distinct.

22 The Phase II proceeding is to get to those
23 very specific issues that your order identified that the
24 company must address and resolve before any of the power
25 cost deferrals are recovered from rate payers in rates.

00609

1 So those are costs that are on the books, they're past,
2 they're -- under a normalized rate case, they would be
3 out of, you know, test period normalized, and you would
4 deal with them differently.

5 But since you set up the deferred accounting
6 and the specific requirements of your order detailed
7 what the company must demonstrate before they recover,
8 those are separate and distinct from the issues that you
9 would have before you in a general rate case.

10 Q. All right. But then the -- but the net
11 effect of both a rate case and this Phase II no matter
12 how we did it in real time or in a real room, together
13 they would end up constituting either two rates or two
14 rates combined, but rates for the future for rate
15 payers; am I right on that?

16 A. Yes, to the extent that you would determine
17 that some level of deferred costs are appropriate. You
18 could combine them into one rate and perspective
19 collect them from rate payers. If that's your question,
20 the answer is yes.

21 But why the Staff put its recommendation the
22 way we did is we think that the issues surrounding the
23 prudence of how the company managed its resource
24 portfolio in the period that the deferred costs arose
25 are distinct from the kind of prudence issues that you

00610

1 would normally have in a general rate case where you
2 would look at the new resource acquisitions, Coyote,
3 let's say Rathdrum, and any of those kinds of issues on
4 a long-term kind of going forward basis, and I think
5 they're separate and distinct, and Staff's
6 recommendation is for the Commission, to make it
7 manageable, is to keep them separate.

8 Q. All right. Turning to the bottom of page
9 three and then going over to page four of your
10 testimony, you have laid out the essential elements of
11 the Staff's recommendation.

12 A. Correct.

13 Q. And I just want to go through them. First
14 with respect to the 90 day period, why 90 days? Is that
15 because that's the amount of time that is needed in
16 order to get the company in here with more information,
17 or is -- why not six months, for example?

18 A. It -- in my mind, it has to do with
19 attempting to get the issue resolved before the company
20 closes its books for 2001.

21 Q. And why is that important?

22 A. Because it has a significant element on its
23 books regarding deferred power costs, and I think it's
24 before the company publishes another financial
25 statement, I believe that the issues related to

00611

1 everything that it has on its books today regarding
2 those deferred expenses should be resolved for the
3 benefit of the financial community, rate payers, and the
4 company as to what's the ultimate disposition of those.

5 It's just hanging out there. It started
6 small, it kind of grew and grew, and it's become
7 something that is, as I heard Mr. Eliassen, is
8 significantly burdening their balance sheet, and I
9 believe that has to be resolved expeditiously. And we
10 put 90 days in there as a temporary time with an effort
11 to try to get that Phase II case resolved as soon as
12 possible so we know what's the outcome and the
13 resolution of those deferred power costs.

14 Q. So your recommendation is that we complete
15 Phase II before the end of the year in order that the
16 company be able to have a final determination of those
17 -- of the prudence of the deferred costs in order to put
18 on its financial statement?

19 A. That's correct.

20 Q. If you were in a bank's position and we were
21 giving relief for 90 days, if we adopt the Staff's
22 recommendation, isn't it the case that there would --
23 there is no assurance of any kind in such an order that
24 there will be any more after the end of the 90 days; is
25 that correct?

00612

1 A. No, there is not, but there is assurance at
2 least with the Staff recommendation that what we
3 attempted to do was craft the amount that we think for
4 90 days gets you to be able to finance through the end
5 of the year, resolve the issue.

6 And the critical difference between the
7 company and the Staff case is to then have those
8 revenues be unencumbered so that we know how much of
9 those deferred power supply costs can be amortized and
10 are appropriate for rate recovery, so that the concern I
11 have is that --

12 Q. You're going on too long just because I am
13 genuinely losing my train of thought.

14 A. I'm sorry.

15 Q. So sticking -- are you saying that we, from
16 the bank's point of view, we would not be giving any
17 assurance of any payment past the 90 days, we would be
18 giving assurance of some kind of process to determine
19 whether there would be more?

20 A. That's correct.

21 Q. In a fairly expedited way?

22 A. Yes.

23 Q. All right. Now going to the next element,
24 terminating the deferred account effective June 30th,
25 what is your reasoning for that cutoff?

00613

1 A. If I could direct you to my testimony at page
2 21, it starts on line 19.

3 Q. Yes, and I have a note on this page too.

4 A. Okay, well, maybe we --

5 Q. And my note says for lines 19 through 23,
6 explain your logic.

7 A. Okay.

8 Q. We'll see what you say first.

9 A. Let me explain my logic in the context of
10 answering your first question as I understood it had to
11 do with why the termination. First off, in two previous
12 occasions under fairly comprehensive records, the
13 Commission has rejected PCA proposals by this company.
14 My concern is the way the company has booked this and
15 what they're asking the Commission to do today is more
16 generous than anything that the Commission has
17 previously granted or previously rejected from a PCA
18 proposal, so I find it troubling that on the one hand
19 you would reject a PCA proposal but then on the other
20 hand have a deferred accounting mechanism that's more
21 generous than anything that the company has heretofore
22 proposed and been rejected by the Commission. That's my
23 first reason.

24 Q. Let me stop you on that reason. Have the
25 prior cases involved companies that have been coming to

00614

1 us saying, if we don't get this money, we won't be able
2 to pay our bills? Have the circumstances been as
3 extraordinary as this past year and this situation is?

4 A. They have been in some respects
5 extraordinary, but not related to deferrals. They were
6 related to a combination of bad hydro and construction
7 for new power plants, so it's been a combination of
8 factors, but not in the con -- single context of
9 something related to the circumstances the company found
10 itself in last year when it came to you for the deferred
11 accounting treatment.

12 Q. All right. So but that was -- that was PCA
13 mechanism. Isn't the request before us for emergency
14 relief of a surcharge?

15 A. Yes.

16 Q. Why are we making that the comparison of the
17 two?

18 A. Because it's driven by something that's akin
19 to a PCA mechanism. Why -- had you not -- let me go
20 back and give you a hypothetical. Last summer, had you
21 accepted the Public Counsel's and ICNU recommendation to
22 not set up the deferral, we wouldn't be here today with
23 this. What caused this --

24 Q. Then might we have been here some time ago?

25 A. Yes, but I think we would have been in a

00615

1 different position, and I don't believe that we would
2 have had this cumulative buildup to where we kept -- we
3 kept putting these deferrals on the balance sheet and
4 kept hoping that the plan that the company said that
5 they could mitigate this without a rate increase and all
6 of a sudden now we're here as you described yesterday
7 between a rock and a hard spot, what do we do.

8 Q. Yes, but we all -- didn't we all, and I mean
9 all of us, agree to that. That is wasn't -- isn't the
10 deferred account mechanism something that was presented
11 to this Commission by all of the parties in the room,
12 proposed by all of the parties in the room, and accepted
13 by us. So that may be true, but we all, everyone,
14 agreed that it was a good shot at bringing that deferred
15 account down to zero. It didn't play out that way, but
16 we all knew when we adopted, when we approved it and it
17 was proposed, that there was a chance that things
18 wouldn't go the way that everyone hoped, which is enough
19 hydro to sell at high enough price that we could get the
20 deferred account down to zero?

21 A. Well, that's correct, we had hoped that that
22 happened. I'm talking about when you first set up the
23 accounting in June of 2000. When the initial order --
24 when the company came before you and said, we want to
25 establish this deferred accounting, and we're still

00616

1 hopeful that we will get our treatment for a PCA in a
2 rate case, but absent that, we want this deferred
3 accounting. And the Commission rejected the PCA and
4 then accepted the deferred accounting under the context
5 that at that point it was \$20 Million approximately, and
6 the company's proposal was for a ten year amortization.
7 And we said, okay, we will set this up, but we will get
8 to the prudence, and before we recover it, we've got to
9 go through these hurdles to demonstrate that it's
10 appropriate for recovery. And it just kept growing, and
11 it kept growing.

12 And my concern is that had you approved a PCA
13 analogous to what the company asked for in '88 or some
14 other PCA, I don't know that we would necessarily be
15 here today with this kind of increase. Had you rejected
16 it and accepted the recommendations of Public Counsel
17 and ICNU, we would be in much different circumstances.
18 This thing has --

19 Q. But so what is my question. Here we are,
20 we're here today, we did approve the deferred
21 accounting. It didn't go as planned. The company
22 claims with a fair amount of evidence that does not
23 appear to have been disputed that it is in such a
24 financial condition that it needs recovery of some of
25 those amounts now before we can ultimately determine the

00617

1 prudency or recoverability of it, so that's where we are
2 today.

3 A. Right.

4 Q. So let's get back to the reason for cutting
5 off the June 30th, that was my question. Why are we --
6 why is your recommendation to allow recovery through
7 that period, but not after?

8 A. Because we -- I think it's appropriate to put
9 a bound on the amount that's on the company's books that
10 the original -- the initial petition came to you and
11 said through June 30th, and Mr. Norwood in that
12 proceeding testified to you that said, if power prices
13 continue to escalate and continue high beyond that, we
14 will ask for more. I have some serious -- I agree with
15 Mr. Schoenbeck, I have some serious doubts about some of
16 the actions. I have not come to any conclusions yet,
17 nor has any other Staff about from July 1st forward.
18 But what I wanted to do is establish a bound on what's
19 out there, let's solve that, let's provide for whatever
20 amounts are appropriate for recovery, and let's move
21 forward with a rate case and a determination of what's
22 the proper PCA mechanism. That was my first --

23 Q. You said the original, but let's see, what --
24 under the -- under our currently effective order, when
25 does the deferred accounting end?

00618

1 A. Well, that is a matter of interpretation of
2 the settlement provision. My reading is there's a
3 significant question. I could argue that the deferred
4 accounting does terminate June 30th, 2001. The only
5 condition that the deferral was continued beyond that
6 date was under the settlement stipulation and the plan
7 to manage it without a rate increase, and that was a --
8 the ability to continue the deferral beyond that date
9 was conditioned upon the company managing its power
10 supply balance to zero. There is a significant question
11 as to whether or not you have authorized any deferred
12 treatment beyond June 30th, 2001.

13 Q. Well, I am reading -- I hope I'm reading the
14 right order, but it says we -- it says:

15 The Commission orders that the existing
16 deferred accounting mechanism is
17 extended through February 28, 2003, or
18 until Avista's deferral account balance
19 becomes zero, whichever occurs first.
20 So isn't that presumptively the status of
21 things right now?

22 A. Well, is -- my question is, is that only in
23 the context of their ability to manage it to zero under
24 the plan? I don't -- I'm unsure.

25 Q. Well, I guess I don't want to read the

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1 language too much right now, I just can recall with some
2 specificity, in fact, I got the transcript of our
3 discussion at the time, and I think it was very clear at
4 the time that all of us knew that it might not work out
5 as planned. I don't recall a discussion that we were
6 counting on or assuming that the company would manage
7 its way to zero. We thought that it could manage its
8 way to zero if things went well, but we had elaborate
9 discussion on what happens if the market price goes up
10 or down. We knew the risks.

11 So what I'm having a hard time with is that
12 we did approve -- we did approve the accounting
13 petition, and we did say that it would go until February
14 28th, 2003. Now the company is in here proposing
15 various amendments to it, which is fine, that's what
16 this proceeding is about. But it seems a little odd to
17 me to ex post facto after the fact say, by the way, it
18 ended two months ago.

19 A. Well, but I -- and I said that it's a
20 question in my mind, and I don't -- I have not come to a
21 conclusion to that, and I don't know as a matter --

22 Q. But that's your recommendation, to terminate?

23 A. My recommendation is to terminate, and
24 there's a series of reasons why to terminate.

25 Q. Okay.

00620

1 A. And I was trying to go through those, and the
2 first reason, as I stated, was that I'm uncomfortable
3 with the PCA, I mean with the deferral mechanism acting
4 like a PCA, and the Commission has rejected PCAs before.

5 The second thing is that, is the reason we
6 just discussed, is the settlement stipulation in effect
7 approved the continuation of the deferred accounting,
8 but on the basis that the company would manage it, but
9 how? So there is in my mind a question as to whether or
10 not the deferred accounting is -- is your approval of
11 the deferred accounting beyond June 30th, 2001, only on
12 condition that the company manage its deferred balance
13 to zero by February 2002.

14 Q. So under that interpretation, as soon as the
15 company hasn't managed the deferred accounting petition,
16 it self terminates, or we determine after the fact that
17 it did terminate?

18 A. There is a question about that.

19 Q. All right.

20 A. The third, and this is the one that causes me
21 the biggest concern, this has to do with the accounting
22 of these costs under FAS 71, and Mr. Lott testifies
23 extensively to this. There is a problem with the
24 company's balance sheets, and that uncertainty that's
25 surrounding what is it, what did the Commission do, and

00621

1 is it appropriate for cost recovery. And then I
2 think --

3 Q. Well, let me stop on that one then, because
4 there's -- we have had quite a bit of discussion about
5 what the company does with its balance sheet, what the
6 financial advisors, what the banks look at, what
7 Deloitte & Tausche looks at, and my initial reaction
8 anyway is, we have our job to do, and they have their
9 job to do, and we have to get whatever documentation we
10 need for our decisions, which can include, you know,
11 interim rates or surcharges or ultimate prudence, rate
12 case, et cetera, but that our job is not to tell the
13 bank or the company or the financial advisors for that
14 matter what should or shouldn't be on the balance sheet.
15 They're looking at us and what we do, and they can
16 listen to these proceedings, and they can read our
17 orders, but that it doesn't seem to me we should be
18 operating so that we can make sure that the bank or the
19 company gets the right thing on its balance sheet.

20 A. Oh, I disagree, particularly when it comes to
21 regulatory assets, because Commission orders create
22 those, and there's very specific guidelines. And I
23 think if you would follow this up with Mr. Lott, he'll
24 be -- he can -- as a CPA he can testify to this further.
25 But Staff's concern and -- is that it appears that the

00622

1 company created a regulatory asset by the way it booked
2 it on its balance sheet, but I would prefer that if you
3 on the specifics of that and the testimony take that up
4 with Mr. Lott.

5 There is a real concern about the company's
6 actions to date regarding these deferred power supply
7 costs and how they booked them and the position it
8 ultimately puts the Commission in for later cost
9 recovery. It's a big concern of Staff's, and I would
10 ask you to please take up that further with Mr. Lott.

11 But I have tried to summarize in a general
12 way why I'm recommending and why Staff is recommending
13 that the deferral stop with the third item on my
14 testimony there beginning on line ten. But I do believe
15 that what you do is significant in that regard, that you
16 are telling the company what it can and can't do with
17 respect to regulatory assets on its balance sheet.

18 Q. But don't we do that on the timetable and
19 conditions that we operate within, that is perhaps some
20 emergency relief and perhaps a later Phase II or a rate
21 case? The phrase kept occurring to me as I was
22 listening to this that accounting is a good servant but
23 a poor master. That is, we need to take into account
24 all this accounting, but bottom line, aren't we trying
25 to deal with the real world here, which is the wholesale

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1 market and hydro conditions, et cetera, turned upside
2 town down and topsy turvy in the last year. Obviously
3 anyone who had to buy power in that market had to pay a
4 very high price. Obviously that would change the
5 circumstances for any company, whether they're, you
6 know, a net seller or a net purchaser. They're all
7 affected by it. All of the financial community looks at
8 the West differently because of this.

9 So here comes Avista telling us their
10 particular circumstances, that they need some kind of
11 relief soon, and aside from accounting types of
12 considerations, and bearing in mind some of the general
13 regulatory principles, aren't we here to address, one,
14 whether they have got an emergency and need emergency
15 relief, and if so, how do we address that emergency, not
16 really how do we get to the next rate case, but how do
17 we address whatever it is that is causing their
18 precarious circumstances, within limits?

19 A. Right, and this is what the Staff crafted a
20 recommendation for the Commission in -- with that in
21 mind.

22 First off, I wanted to get to the point that
23 you made or the question that you had about accounting
24 and the master, and are we a master or a slave to it.
25 For regulatory accounting purposes and the creation of a

00624

1 regulatory asset, that -- the ability to do that is by
2 order. It's very specific. And that there are specific
3 requirements, and there are specific guidelines under
4 GAAP and how those -- how those regulatory assets ought
5 to be recognized, and Staff has serious concerns about
6 what your order stated and what the company subsequently
7 did with those deferred power costs and how it --

8 Q. But isn't it the bankers who make their own
9 decisions about -- I mean they can read our orders. Or
10 are you saying the company should not have -- well, are
11 you saying we do or don't have control over how the
12 company presents itself to the external world? Do we
13 have control over that?

14 A. Yes, when it comes to regulatory assets and
15 the creation of those.

16 Q. Well, we have control over our own orders and
17 our own proceedings, and we can declare something -- we
18 can set up a deferred account, we can allow recovery, we
19 can not allow recovery.

20 A. Well, but you also look at your -- now I'm
21 not trying to practice law here, but I would also
22 commend you to the statutes regarding the Commission's
23 authority to be very prescriptive about books and
24 accounts and the records that the company keeps and how
25 it presents itself for purposes of accounting, both on

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1 the regulatory side, and then I think this is always
2 kind of a very tenuous thing with this particular issue
3 is that you are right, the power markets did go haywire,
4 not -- but it wasn't just the power markets that went
5 haywire, there are issues about the company's decisions
6 to be short. There are issues about how a deferral is
7 calculated. There are issues, you know, you have those
8 issues that you outlined in your order. We need to get
9 to those to say, before the company can reasonably
10 recover those, they have to address all of these issues,
11 then it's appropriate for recovery, then you can put it
12 on the balance sheet.

13 My understanding of what your order did was
14 say, here's -- you're going to have these power costs,
15 book them, come back later once you have -- you can
16 address these issues, and we will determine their
17 appropriateness. Staff's concern is precisely how they
18 did it and what they reported to the financial
19 community, and it has created a burdon on their balance
20 sheet that's now put the Commission in this position in
21 my estimation.

22 Q. Let me turn to a different case, and that is
23 PacifiCorp's last rate case; were you involved in that
24 case?

25 A. Yes.

00626

1 Q. Didn't we there authorize a permanent rate
2 without finding prudent some of the assets that
3 presumably the rate covered?

4 A. That's correct, but one of the issues in that
5 case, I recall the testimony and the dialogue that we
6 had regarding that, is that one of the problems that you
7 have in a prudence determination is first off, was the
8 company prudent. And then the second question, and this
9 is the more difficult one, is how do you hold rate
10 payers harmless. And I felt that the rates that we were
11 providing under the rate plan for PacifiCorp, even if we
12 got to a finding that the company on one particular
13 resource or another was imprudent, I didn't feel that
14 the remedy that Staff would have proposed in that
15 context would have gotten to a point where the rates
16 that were proposing from the plan were not fair, just,
17 and reasonable.

18 Q. So like the company in this case and
19 Mr. Schoenbeck to a lesser extent in this case, in the
20 PacifiCorp case, you felt comfortable that we could go
21 ahead and authorize a rate even though we had not and
22 still have not, unless it came through on a consent
23 order, determined the prudence of some of the costs that
24 were probably included in those rates?

25 A. That's correct.

00627

1 Q. All right. So now I want to jump back to
2 this case. One of the points that the company is making
3 and Mr. Schoenbeck to a lesser extent is that there are
4 enough costs that have accumulated in the deferral
5 account on which one or the other is confident that they
6 will recover, that in the one case of a 30 month
7 recovery period or in the other case a 15 month recovery
8 period of a 33% plus rate increase is justified.

9 A. Mm-hm.

10 Q. Is that how you would read their --

11 A. The company's case and Mr. Schoenbeck's ICNU
12 case? Yes, well, Mr. Schoenbeck's case and the company
13 case are a lot different in that regard. The company's
14 case is extending out for a substantial period, looking
15 at estimates including capital costs for Coyote,
16 calculating deferrals, and saying here's how much we
17 need to get this to zero.

18 Mr. Schoenbeck took a very limited view, and
19 this is something that Staff would do in Phase II,
20 Mr. Schoenbeck had enough time to generate what he would
21 be comfortable recommending to the Commission as
22 appropriate for Phase II recovery, an amount.

23 Q. All right. But he had enough confidence
24 anyway that through the June expenditures, he felt there
25 was about a 95% recovery of the amount that he -- 95% --

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1 he was about 95% sure --

2 A. Right.

3 Q. -- that all of the company costs, I think,
4 would be recovered, something along those lines. So my
5 question to you is, let's just take that same time
6 period, of why aren't you approximately as comfortable
7 as Mr. Schoenbeck?

8 A. Well, we have not done the analysis, but our
9 recommendation is to provide the temporary -- an
10 approximation of the amount that the company is seeking,
11 some 33%, for a 90 day period. Within that period as
12 expeditiously as possible solve the prudence question.
13 Prudence, I mean all of -- I'm using it like Mr. Ely
14 used the word, and then -- then we will have an ability
15 to apply that to the deferrals, and the company can
16 amortize that. Staff has not had the opportunity to do
17 that analysis.

18 Q. Well, it --

19 A. We did the analysis on the flip side that
20 Mr. Schoenbeck didn't do, and that is if you apply the
21 interim standards, how much? So that's the analysis
22 Mr. Schooley did. We took slightly different tracks,
23 but I think we came remarkably close in our
24 recommendations, that he has a level of costs that and a
25 way to calculate those that, as I read his testimony,

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1 seemed to be, on the limited basis that I have analyzed
2 it, seems reasonable.

3 I don't know what Staff is going to do. We
4 have issues about how do you calculate the --

5 Q. You need to keep your answers shorter.

6 A. I'm sorry.

7 Q. I really do lose my train of thought, and I
8 have more questions, and I simply can't remember them.

9 A. Okay.

10 Q. Back when you were talking about wanting to
11 expedite the Phase II process before the end of the
12 year, you didn't say to the end of the year, but I want
13 to contrast that with the PacifiCorp case, because there
14 the Commission was very concerned about setting in rates
15 -- putting in rates that -- without finding prudence and
16 waiting for five years until we would determine that
17 issue, or possibly one year, a one year proceeding.

18 And one of the arguments there was, there
19 wasn't enough time to really do a good job on prudence.
20 And, you know, there was testimony about if we had to
21 hurry up and do prudence that a couple of counsel
22 wouldn't be able to put a good record in and et cetera,
23 et cetera. And if we took a whole year to determine
24 prudence, we would have I think the term was some
25 elegant report to sit on the shelf for the next four

00630

1 years. That was Mr. Lazar's phrase.

2 So I will put that same question here. We
3 can either kind of take, you know, make some kind of
4 judgment and grant relief subject to a fairly thorough
5 review of recoverability, including prudence, or we can
6 really not go forward, 90 days is 90 days, but it's no
7 assurance for anything after that, and force ourselves
8 to answer all of those questions very quickly and
9 perhaps hastily I guess in order to satisfy what, I
10 guess in order to be certain that our order is the
11 correct one and to get it on the books in time for the
12 year, to finish before the end of the year.

13 And what I am struggling with is why it's so
14 important to do it in that format. Why not look at the
15 company's situation, grant some relief subject to
16 refund, take the time that we need and that does -- that
17 just -- that is an amount of time that's really not
18 responsive and can't be responsive to emergency
19 situations, but correct it later if need be, all with
20 the very large caveat that whatever we do to begin with,
21 I think we have to have, you know, a rough certainty, I
22 mean a rough comfort with.

23 A. Well, if -- I guess in your hypothetical in
24 trying to answer it in the context of Pacific and this
25 case and the accounting order and what you're

00631

1 comfortable with, if you want to amend your accounting
2 order to say that this level of cost is appropriate for
3 cost recovery, that's well within your discretion. If
4 you have enough confidence in the evidence that's before
5 you to do that, then that's your prerogative.

6 What Staff tried to do was stay true to your
7 orders and what you had previously done with respect to
8 setting up this deferral. And if your comfort level is
9 such that some amount of refund they're entitled to and
10 you want to go forward on that basis, I think that you
11 may do that, and I'm not so sure what other parties
12 might do as a result of that order, but it -- I think
13 that -- I think you have that discretion.

14 But your order says no cost recovery until
15 you demonstrate prudence, and so that's what Staff tried
16 to craft, a remedy to deal with this very complicated
17 case and be true to what you said in your prior orders
18 and be true to the interim relief standards and our
19 overall general rate making policies and principles that
20 we use for general rate applications. That's what we
21 tried to do. We tried to put it all together in a
22 package that fits. This was our best shot.

23 Q. But do you think that adhering to all of
24 those factors also responds appropriately and can
25 respond appropriately in general to emergency

00632

1 situations?

2 A. You have that discretion, but if you do that,
3 my testimony is to be very careful in your order to make
4 clear that you're doing it -- that interim rate relief
5 belongs in a general rate case, and because it's the
6 nature, you have everything in front of you, and this is
7 the Staff recommendation, that this -- this is a
8 surcharge and how -- and I think Staff strongly believes
9 that you need to make that finding of prudence and
10 appropriateness and address those issues that you
11 identified in your order before you provide cost
12 recovery. That's what your orders stand for today.

13 Q. What is the difference between interim rate
14 relief when a rate case has been filed and we grant
15 interim rate relief pending the outcome of the rate case
16 and this request, we will call it a surcharge, if the
17 same conditions are met and there is going to be a rate
18 case filed? What do you see as the distinction there?

19 A. Well, in the general rate case, I think that
20 you have more information in front of you regarding
21 things that we have not yet had a full evaluation of,
22 and that is construction budgets, deferred operation and
23 maintenance that's reasonable, the fully restated
24 operations of the company, and you're evaluating a
25 request pending the outcome of a final order on our

00633

1 restated pro forma results of operations. That's what
2 interim rate relief has stood for for many years in this
3 agency, and that's what we're trying to advocate that
4 you continue to adhere to. So we tried to create a
5 bridge, a stopgap mechanism so we can get to that
6 process, and this is what we came up with.

7 Q. I guess the last question I have is if we do
8 adopt the Staff's recommendation, do you believe that
9 the company will remain financially viable and healthy?

10 A. Yes.

11 Q. What's your grounds for that?

12 A. Well, first off, I believe the company is --
13 gets the relief it has asked for. The second --

14 Q. Well, it clearly wouldn't. I mean we would
15 be adopting the Staff -- my hypothetical was if we adopt
16 the Staff recommendation, which clearly isn't what the
17 company is asking for.

18 A. The company -- and I would ask you to pursue
19 this technical issue about the cash on the balance
20 sheet, but there appears to be some issue about the
21 Staff recommendation and whether the relief that you
22 grant is somehow encumbered and can't be used. I
23 believe that if you grant the interim relief subject to
24 refund, it becomes general cash, and the company can pay
25 down short-term debt, and that improves its financial

00634

1 flexibility.

2 The second thing that's a benefit is you
3 establish a time line for when the prudence will be
4 resolved. We have to get that monkey off our back for
5 everybody's benefit. You have to determine what's
6 proper for recovery. Get that resolved as expeditiously
7 as possible, and it's not whether the company has to
8 write off \$50 Million or \$5 Million or all of it, but
9 the fact is it's uncertain. If they have to write all
10 of it off, it's final. We -- then at least that's water
11 under the bridge, the financial community now can look
12 at the company with fresh perspective and look at its
13 prospects. But that deferred asset on its books is
14 creating uncertainty that the financial community is no
15 longer tolerating.

16 Q. What would be the effect if we authorized the
17 surcharge as requested by the company, that is for the
18 next 30 months or 27 months, whatever it is, but had an
19 expedited Phase II proceeding to determine the prudence
20 of whatever, I suppose whatever costs had been incurred
21 thus far, and so finalized those before the end of the
22 year, but didn't start out in advance with a cutoff date
23 of 90 days?

24 A. That's an option.

25 CHAIRWOMAN SHOWALTER: Thanks.

00635

1 THE WITNESS: You're welcome.

2

3 E X A M I N A T I O N

4 BY COMMISSIONER HEMSTAD:

5 Q. Under the Staff proposal, what will be the
6 situation after June 30 of next year?

7 A. Of next year or --

8 Q. Well, I'm sorry.

9 A. This year?

10 Q. There are so many dates floating around, I
11 have to go back to my notes, I'm sorry.

12 A. I understand your question. The option would
13 be that the company could -- would have to do one of two
14 things. It depends on what your order said. If it said
15 no deferring whatsoever --

16 Q. Well, I'm asking if we adopted the Staff
17 proposal.

18 A. If you adopted the Staff proposal, then the
19 company would have to begin to recognize the expenses in
20 power supply as they are incurred.

21 Q. Because a deferral would have been cut off?

22 A. The deferral would have been cut off. There
23 would be no even basis for creating a side -- an
24 account. There would be no basis for even booking it in
25 186 to miscellaneous deferred debits.

00636

1 Q. Okay. And I believe the company testified
2 yesterday that it would be in a situation when then they
3 would have to write off whatever the remaining balance
4 that had not been collected with the surcharge?

5 A. Well, the writeoff is an incorrect term.
6 They would have to expense it in this period, so their
7 financial statements would reflect the expense. The
8 writeoff has to do with the piece up to June 30th that
9 we're saying is deferred and subject to Phase II.
10 That's already on their books, and the question is,
11 what's properly recoverable, and if it's all recoverable
12 and it all stays on their books and there's some kind of
13 amortization and there's some kind of recovery mechanism
14 and there's no writeoff. But from June 30th forward,
15 there's no writeoff, there's the expensing of those
16 power supply costs for current financial reporting
17 purposes.

18 Now one option the company could do is come
19 back before you and petition for a side record so that
20 it could ask for cost recovery of those deferred --
21 those heretofore deferred power supply expenses for
22 recovery in the future rate case. That would be one
23 option the company might have under Staff proposal.

24 And then as Mr. Schoenbeck testified and some
25 discussions I have had preliminarily with Staff on that,

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1 is that there are major concerns about the ongoing
2 deferred amounts in the decisions for the July 1st
3 period forward. I think, and in answer to one of your
4 questions, I think a couple of the deal sheets are
5 already in the record, I think they're through
6 Mr. Norwood. If you give me a moment, I will give you
7 the specific cite to those exhibits would be 109-C, so
8 those transactions in that time frame, there's some
9 significant concerns about the propriety of those and
10 what actions the company took. So we have to
11 investigate that.

12 But it's not to say that the company could
13 not come back again and saying, from that period
14 forward, let us create the side record and let us create
15 some kind of mechanism so that we can bring those costs
16 to you and ask for cost recovery in a future case. But
17 then it's very clear and unequivocal that there's no
18 basis for including that on the balance sheet.

19 Q. If my memory serves me correctly, I think the
20 company's testimony yesterday was to the effect that in
21 so many words that that would not be acceptable to their
22 bankers. Is that how you heard it?

23 A. Yes, that's how I heard it.

24 Q. You're not a banker, I realize, do you have
25 any opinion with regard to that conclusion?

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1 A. Bankers like certainty, and that's -- that is
2 -- with that kind of creed in mind, if you provide some
3 certainty as to what you're going to do and what's going
4 to be the outcome in a process, I think that goes a long
5 way for the company to finance, to obtain the necessary
6 waivers, and to get through this problematic time.
7 That's my opinion.

8 Q. Could you succinctly describe to me how, in a
9 summary form, how the Staff proposal compares with
10 ICNU's proposal through Mr. Schoenbeck, or what are the
11 differences, the significant differences?

12 A. The significant -- the first significant
13 difference is Mr. Schoenbeck would continue the deferred
14 accounting and create the specter of possible writeoffs
15 in the future. And Staff would prefer not to have that.
16 So that's one difference. Mr. Schoenbeck's proposal is
17 different in the sense that he has done a Phase II
18 analysis. He basically testified today what ICNU is
19 prepared to provide for Phase II level of recovery.
20 Staff has not done that.

21 So let's just say hypothetically that the
22 Staff would look at Mr. Schoenbeck's analysis, and say
23 we support that, then you would have then in Phase II a
24 basis for saying this is appropriate, and we presented
25 that recommendation and cut through the process, you

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1 would have an amount that you could say would be cost
2 recovery, and that would be certain. You would still
3 have -- as I said the difference is for -- we're
4 recommending the deferral stop. He says continue it,
5 give me some more time to evaluate, and then I will tell
6 you how much in that second piece that the company
7 should be provided.

8 And his -- the other difference is the
9 treatment with respect to the PGT.

10 Q. I'm sorry?

11 A. The PGE.

12 Q. Oh, PGE?

13 A. PGE money and accelerated amortization of
14 those amounts, and I think that's --

15 Q. Well, now there's a significant ultimate
16 difference in surcharge level. You stand at 32%, and
17 he's at 11%, thereabouts?

18 A. Right, and that difference is caused by the
19 testimony that you heard earlier that he did not look at
20 the financial covenants and the ratios in the very near
21 term, where Staff took the other side, and we put our
22 efforts into that analysis as opposed to what would be
23 the reasonable amount for a prudence determination in
24 Phase II, so we -- and that's why you have a difference.

25 COMMISSIONER HEMSTAD: Thank you.

00640

1

2

E X A M I N A T I O N

3

BY JUDGE MOSS:

4

Q. Just a couple of things to clear up for me.

5

You used the term side record. I'm unfamiliar with that

6

term. I wonder if you could define it for me.

7

A. Would you please ask Mr. Lott that?

8

Q. All right. And it may be that I should defer

9

this question to Mr. Lott as well, it's related. As I

10

understood some of the earlier testimony in the

11

proceeding, if the Commission were to terminate the

12

deferral account as of June 30, 2001, per Staff's

13

proposal, there -- it apparently is the case that there

14

will be an accumulation of otherwise deferred power

15

costs that will accrue during July, August, and

16

September that was in an amount of about \$74 Million, if

17

I recall correctly. And but there was a suggestion at

18

least in some of the testimony that I am presuming under

19

principles of retroactive rate making that that money

20

would never be recoverable by the company. And this

21

side record may be the way Staff, for lack of a better

22

word, finesses that point and says, well, no, that's not

23

necessarily the case, perhaps you could include that \$74

24

Million in some future rate case. But under the usual

25

principles of regulatory rate making, past costs that

00641

1 weren't recovered during the period when they were
2 expensed are never recoverable.

3 A. That is correct, but this issue of what is
4 retroactive rate making has been very contentious in
5 this building since the Commission first approved
6 Puget's energy cost adjustment clause. We call it ECAC,
7 E-C-A-C, the ECAC. In -- and I would commend you to
8 look at the Sixth Supplemental Order where that was
9 reopened. The Commission made a distinction in that,
10 and here's the best that I can explain to you what --
11 why the Commission has determined that what we do with
12 deferred accounting is not retroactive rate making.

13 Q. Well, I understand that piece.

14 A. Okay.

15 Q. It's the \$74 Million is not going to be part
16 of a deferred account under your proposal. That's why
17 I'm concerned about it.

18 A. Well, if you create the side record, and
19 there's a -- there's -- I don't know the cause, but
20 there was a side record created in a Puget case
21 regarding, and I would ask you to follow up with
22 Mr. Lott, the Commission in a previous case created a
23 side record for some deferred or some nuclear costs, and
24 it ruled that -- it kept the side record so it could
25 determine what to do with them in a rate case, and then

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1 it determined in a rate case it had the authority to
2 look at that side record and determine what's the
3 appropriate way to treat them.

4 Q. Hm.

5 A. But I did want to add one other feature is
6 that in this kind of pendency phase, one thing that
7 might be an option to consider is that the side record
8 could be, you know, a material disclosure on the
9 financial statement, that we are booking these, but
10 recovery is clearly uncertain pending this other case.
11 But you -- depending on how long you take, that thing
12 builds up, and, you know, the distinction between side
13 records and deferred accounting and 186 and regulatory
14 assets, the specifics, I would say Mr. Lott is the
15 person to clarify those for you. But I do know we have
16 addressed those in the past with Puget, and there may be
17 another instance, but it's not coming right to my mind.

18 Q. But I draw from some of the remarks you have
19 made that both because retroactive rate issues are by
20 their nature somewhat controversial and certainly not
21 crystal clear in the professional literature or perhaps
22 in the minds of all of us in the room, that is
23 tantamount to creating uncertainty if we treat it that
24 way. In other words, someone can make the argument that
25 that's retroactive rate making and that those costs can

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1 not be recovered unless they are clearly in a deferred
2 account and therefore subject to future treatment?

3 A. Right, and, in fact, that's the position we
4 are in today, that if, in my mind, is that the
5 Commission exposes itself to that very kind of lawsuit.
6 If it were to provide some kind of cost recovery without
7 a finding of prudence, that there is this potential for
8 somebody to bring back that cause before a superior
9 court and question the propriety of recovering those
10 costs before a finding has been made that they're
11 appropriate for rate making and prudently incurred.

12 Q. Does that take into account that they would
13 be being collected subject to refund specifically
14 conditioned upon there being a prudency finding?

15 A. I can't answer that. I don't know -- I --
16 that's just way -- real speculative now. It's way out
17 there.

18 Q. Changing subjects, you suggested in part of
19 your response to some of the other questions from the
20 Bench that the Staff proposal is I think you used the
21 word true to the Commission's prior orders, and the
22 question I want to put to you, isn't the company's
23 proposal also true to those orders in the sense that it
24 calls for the collection of these dollars subject to
25 refund and would set up a process different from yours,

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1 but set up a process to consider these lingering issues
2 from the prior orders?

3 A. No, it's not. And the very real difference
4 is that the company wants to take those dollars, and
5 once they start collecting them, to begin to amortize
6 the deferred amounts on its balance sheet. That's the
7 critical difference.

8 Q. And is that for regulatory accounting
9 purposes, for financial accounting purposes, or both?

10 A. Both.

11 Q. And to clarify another point related to that,
12 while the Commission does exert more or less plenary
13 power over regulatory accounting by the company, we
14 don't really except indirectly exert control over their
15 financial accounting, do we?

16 A. I would defer that to Mr. Lott. I think for
17 purposes of FAS 71 and what your orders stand for and
18 what's out there, you may have that authority, but I
19 would defer that to Mr. Lott.

20 JUDGE MOSS: Okay, I will take it up with
21 him. That's all I have. Thank you very much.

22 MR. MEYER: May I have very limited recross?

23 JUDGE MOSS: Based on the questions from the
24 Bench?

25 MR. MEYER: Yes.

00645

1 JUDGE MOSS: All right.

2 MR. MEYER: Thank you.

3

4 R E C R O S S - E X A M I N A T I O N

5 BY MR. MEYER:

6 Q. Commission Hemstad talked about or engendered
7 a discussion about the \$74 Million worth of deferred
8 costs incurred in the July through September time frame.
9 Do you remember that colloquy?

10 A. Yes, I do.

11 Q. Okay. And you were also asked about whether
12 those costs, if not reflected in a deferred accounting
13 mechanism that was continued beyond June of this year,
14 would ever be recovered through rates. Do you recall
15 that dialogue?

16 A. I recall, but I'm not sure I would
17 characterize it -- if you can maybe rephrase the
18 question.

19 Q. Well, let's approach it in a different way.
20 Whether we characterize the \$74 Million as costs that
21 would be "written off" or as costs that would be
22 "expensed" during the third quarter, given your
23 proposal, what do you think the probable reaction of the
24 investment community would be to a situation where
25 Avista was expensing in the third quarter \$74 Million in

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1 costs if it could not recover those from rate payers?

2 A. Well, there, candidly, there would be some
3 concern on an ongoing basis. But the question in my
4 mind is still, are these costs appropriate for a rate
5 recovery. So the uncertainty is still there. I think
6 to the extent that there might be some finality with
7 that and to the extent that these would be expensed and
8 that's how they're booked, I think the financial
9 community, like I responded to Commissioner Hemstad,
10 steady uncertainty is what bankers don't like.

11 MR. MEYER: Thank you, that's all I have.

12 JUDGE MOSS: Mr. Trotter, redirect?

13 MR. TROTTER: Thank you.

14

15 R E D I R E C T E X A M I N A T I O N

16 BY MR. TROTTER:

17 Q. With respect to the Staff's recommendation to
18 have the deferral terminate effective June 30, is that
19 part of the overall plan that the Staff is proposing?

20 A. Yes.

21 Q. Should it be considered in that light?

22 A. Yes, it should be.

23 Q. One of the questions you were asked about,
24 and let's just turn to page three of your direct
25 testimony, the 32.6% rate increase for 90 days subject

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1 to continuation. Could you turn then over to page four.
2 Is the continuation that you had in mind described on
3 line -- beginning on line 12?

4 A. Yes.

5 Q. Now with respect to the issue of what's been
6 called Phase II issues, the recoverability issues, is
7 the Staff's ability to expeditiously address those
8 issues dependent on the company filing its direct case
9 and responding to the outstanding data requests on those
10 issues?

11 A. Yes, we still have significant amounts of
12 data requests outstanding that have not been responded
13 to and that are critical to our evaluation of the
14 propriety of those costs.

15 Q. Is the Staff committed to expeditiously
16 resolving the general rate case that the company itself
17 is committed to file?

18 A. Yes, we are.

19 Q. And if the company files a case that
20 minimizes to the extent possible contentious issues,
21 will that promote the process?

22 A. Absolutely.

23 Q. You were asked some questions about
24 compliance with financing covenants. Is Mr. Schooley
25 the witness that discusses that issue for Staff?

00648

1 A. Yes, he has done the analysis and has the
2 recommendation.

3 MR. TROTTER: That's all I have, thank you.

4 JUDGE MOSS: Thank you, Mr. Trotter.

5 One question and answer there prompted me to
6 ask yet one more, Mr. Elgin.

7

8

E X A M I N A T I O N

9

BY JUDGE MOSS:

10 Q. Mr. Trotter asked you about the pending of
11 the deferral being a part of Staff's overall proposal,
12 and it should be viewed in that context I believe was
13 your response. And there's some direct testimony also
14 that leads me to the question of whether it is the case
15 as the Commission considers what to do, the Commission's
16 view of Staff's proposal should be one of it all hangs
17 together or it all falls apart. In other words, is
18 every element of it necessary to be adopted in your view
19 if it's going to work?

20

A. No.

21

Q. And what could we safely put to one side, as
22 it were?

23

24

A. I think that you could safely continue the
24 deferral but recognize that the balance is growing, and
25 the bigger the balance gets, the more difficult it is

00649

1 for the Commission in my mind ultimately to say some
2 level of these costs are inappropriate in cost recovery.

3 My experience in that regard is with the
4 Puget Sound Power and Light prudence case, that the
5 adjustment was so big that it was very difficult in my
6 mind when reading the Commission's order for it to make
7 the proper remedy for rate payers on the cost side. So
8 you could do that, but I would caution you there, it
9 just grows.

10 I would not provide -- I would seek some --
11 if you want to provide the interim kind of relief that
12 we recommend, and I would say that you -- that's the
13 thing that ties that together is no amortization until
14 we get the prudence finding. Those two things are
15 inseparable.

16 The deferral, the continuation of the
17 deferral and that outcome and what we do in the case, I
18 think that's one that you could -- and I believe that
19 the Commission should stick to the evaluation of interim
20 relief in the context of a general, where we have more
21 information in front of us to make a fully informed
22 decision about covenants, financing, budgets,
23 construction, options, decisions, and how we proceed
24 there to get the company over its need for interim rate
25 relief.

00650

1 JUDGE MOSS: Okay, thank you.

2

3 E X A M I N A T I O N

4 BY CHAIRWOMAN SHOWALTER:

5 Q. You said no amortization until there's a
6 prudency finding, amortization of what?

7 A. The deferred amount on their balance sheet,
8 the \$109 Million that's through June 30th plus the \$74
9 Million that's from July 1st to present that's been
10 testified yesterday and today, those amounts.

11 JUDGE MOSS: Anything further?

12 All right, Mr. Elgin, we thank you very much
13 for your testimony, and we believe we can release you
14 from the stand subject to recall as we have the other
15 witnesses.

16 We will be off the record for a minute.

17 (Discussion off the record.)

18 (Recess taken.)

19

20 (The following exhibits were identified in
21 conjunction with the testimony of THOMAS E. SCHOOLEY.)

22 Exhibit 401-T is Pre-filed direct testimony.
23 Exhibit 402 is TES-2 Financial Indicators: Actual Fixed
24 Charge Ratio compared to Projected Fixed Charge Ratio.
25 Exhibit 403 is TES-3 Fixed Charge Coverage Ratio.

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1 Exhibit 404-C is CONFIDENTIAL ICNU Cross-Exam Exhibit:
2 Testimony Work Papers.

3

4 Whereupon,

5 THOMAS E. SCHOOLEY,
6 having been first duly sworn, was called as a witness
7 herein and was examined and testified as follows:

8

9 DIRECT EXAMINATION

10 BY MR. TROTTER:

11 Q. Mr. Schooley, referring you to Exhibit 401,
12 your pre-filed direct testimony.

13 A. Yes.

14 Q. Does that constitute your direct testimony in
15 this case?

16 A. Yes.

17 Q. If I ask you the questions that appear there,
18 would you give the answers?

19 A. Given the errata sheet handed out, yes.

20 Q. You also sponsored two exhibits, Exhibit 402
21 and 403?

22 A. Yes.

23 Q. And are those two exhibits prepared by you?

24 A. Yes.

25 Q. Are they true and correct to the best of your

00652

1 knowledge?

2 A. Yes.

3 MR. TROTTER: I move the admission of
4 Exhibits 401, 402, and 403.

5 JUDGE MOSS: Being no objection, they will be
6 admitted as marked.

7 MR. TROTTER: The witness is available for
8 cross.

9 JUDGE MOSS: Mr. Meyer.

10 MR. MEYER: I'm going to pass on cross in the
11 interest of time. Please don't draw any inferences from
12 that. And I also, of course, reserve the right if
13 anything else comes up to ask permission for some cross.
14 If any other cross triggers something or Commissioners
15 -- the usual procedure. But short answer, no cross at
16 this time.

17 JUDGE MOSS: I have forgotten who is next, I
18 guess it's you, Mr. Van Cleve.

19 MR. VAN CLEVE: Thank you, Your Honor.

20 COMMISSIONER HEMSTAD: Counsel must be hungry
21 or something.

22 THE WITNESS: I'm glad you agree with
23 everything I said.

24

25

00653

1 C R O S S - E X A M I N A T I O N

2 BY MR. VAN CLEVE:

3 Q. Mr. Schooley, if you could look at page ten
4 of your testimony, and starting at line 13, you lay out
5 six standards for interim rate relief. Are these the so
6 called PNB standards?

7 A. Starting on page ten, you say?

8 Q. Right.

9 A. Yes.

10 Q. And in your view, has the Staff had an
11 opportunity to adequately consider the application of
12 each of these standards to the petition filed by the
13 company in this case?

14 A. No, we have not adequately had time to
15 consider all of these standards. We did the best we
16 could within the few weeks we had.

17 Q. If you could refer to Exhibit 403, which is
18 your Exhibit TES-3.

19 A. Okay.

20 Q. Is this the spreadsheet that shows how you
21 came up with the proposed 32.6% rate increase?

22 A. Yes. You're looking at page one, I assume.

23 Q. I'm looking at page one. And could you just
24 tell us what the difference between page one, page two,
25 and page three is?

00654

1 A. Page one is under the hydro assumptions that
2 the company has used. Page two is if the assumptions
3 were changed to critical water levels instead of beyond
4 critical water levels. And page three is assuming that
5 normal water returned, normal hydro levels returned
6 immediately.

7 Q. So if we looked at line 17 on each of pages
8 1, 2, and 3 of that exhibit, it would show the indicated
9 rate increase under each of those scenarios that would
10 be needed to achieve a certain fixed charge coverage
11 ratio; is that correct?

12 A. Yes, line 17 in the right-hand column, yes.

13 Q. Okay. And is your analysis of the need for a
14 32.6% rate increase based solely on an analysis of the
15 impact on the fixed charge coverage ratio?

16 A. Yes.

17 Q. On page 1 of Exhibit 403, if you look on the
18 left-hand column, line 19.

19 A. Yes.

20 Q. And the figure \$178,000,214; do you see that
21 there?

22 A. Right.

23 Q. That is under the heading at the top that
24 says add back financings.

25 A. Right.

00655

1 Q. Can you tell us what that number represents?

2 A. That comes from the company's response to our
3 Data Request Number 166, which asked for a budget of
4 common stock sales and issuances of bonds and other
5 debts for the balance of 2001. Among those items are
6 two common stock issuances and two construction loans
7 for Coyote Springs II. Those are the ones I chose out
8 of there as being the most likely for the company to
9 accomplish during this year. There's also preferred
10 stock, possible, and other short-term debt borrowings
11 which don't necessarily count in the calculation of a
12 fixed charge.

13 Q. How much equity did you assume that the
14 company would issue this year?

15 A. Their projection is that they would issue
16 \$67,600,000 in the second half of this year.

17 Q. If they issued more equity than that, it
18 would reduce the amount of the necessary rate increase;
19 is that correct?

20 A. It would reduce -- they're not necessarily
21 linked. It would reduce the amount that they may need
22 to meet their fixed charge ratio. It's sort of a
23 chicken and an egg type situation where you need to have
24 the surcharge or revenues in order to finance, but you
25 need to have the financings in order to mitigate the

00656

1 amount of the surcharge needed. So whether they would
2 have the bankers agree that issuing stock was a wise
3 thing to do is yet to be decided.

4 Q. Do you know how much equity the company would
5 have to issue to achieve its goal of a 50% equity ratio?

6 A. I believe their data responses, which I don't
7 know if that's an exhibit yet or not, but I think they
8 said 220 Million.

9 Q. Now just as a hypothetical, the 178 Million
10 for add back financings that you have in the line 19 on
11 the left-hand column of this exhibit, would you accept
12 subject to check that if we put a 220 Million number in
13 there that the rate increase necessary to achieve the
14 coverage ratio minimum would be reduced to approximately
15 20%?

16 A. If you have done the calculations right, I
17 will accept that subject to check.

18 Q. And would you also agree that the sale of
19 Coyote Springs II would reduce the necessary rate
20 increase to meet the minimum fixed charge ratio?

21 A. It may do so in the immediate term. I don't
22 know if that would be the long-term, fit any long-term
23 objectives of the company or what Staff and the
24 Commission may see as the wise objective in the
25 long-term either.

00657

1 Q. But my question is what the impact on the
2 fixed charge ratio would be of selling Coyote Springs
3 II?

4 A. I haven't done any analysis to that effect.
5 It seems like if you have reduced your need to borrow,
6 it may improve your fixed charge ratios. Whether that's
7 a -- again, I don't know if that's the wisest thing to
8 do, nor are we in a proceeding that should determine
9 that.

10 MR. VAN CLEVE: That's all I have, Your
11 Honor.

12 JUDGE MOSS: Thank you.

13 Mr. ffitch.

14 MR. FFITCH: Thank you.

15

16 C R O S S - E X A M I N A T I O N

17 BY MR. FFITCH:

18 Q. Good afternoon, Mr. Schooley.

19 A. Hello, Mr. ffitch.

20 Q. You're the witness who examined the company
21 financial information and made the calculation that
22 about \$20 Million of added cash flow in the fourth
23 quarter was needed; is that right?

24 A. Yes.

25 Q. And if you look at page 22 of your testimony,

00658

1 which is Exhibit 401-T, there you say that the one
2 specific index you were able to analyze in the time
3 available was the fixed charge coverage ratio, correct?

4 A. Yes.

5 Q. And so it's correct, I take it, that your
6 analysis did not look at the interest coverage of the
7 company? You did not look at the interest coverage of
8 the company?

9 A. I'm trying to determine if that's any
10 different from the fixed charge coverage. I didn't look
11 at that as a separate item.

12 Q. Did you look at earnings per share of the
13 company?

14 A. No.

15 Q. Did you look at the market to book ratio of
16 the company?

17 A. No.

18 Q. Did you look at trend in the rate of return
19 for the company?

20 A. I think I mentioned that in my testimony, but
21 I didn't look at that. See, I think our proposal is to
22 allow the company the opportunity to show its own needs
23 for interim rate relief within the next 90 days, and
24 therefore, they would have the opportunity to continue
25 beyond the 90 days that we have suggested for the

00659

1 percentage that we have suggested. That's -- I mean it
2 gives the company the opportunity to do its own work.

3 Q. But you have not in making your
4 recommendation here looked at any of the factors I have
5 listed so far?

6 A. No, we had little time to go that in depth.

7 Q. Did you analyze whether the company had an
8 inability to generate sufficient capital from internal
9 sources to finance its construction needs?

10 A. That seemed apparent from the company's
11 testimony.

12 Q. Did you do an analysis of that?

13 A. Other than looking at their numbers they
14 presented, no.

15 Q. Would you accept subject to check that all of
16 those elements I just listed have been used by the
17 Commission in applying the PNB test for specifically the
18 fourth element of the PNB test?

19 A. Yes, those -- that's specifically why I chose
20 one that I could do in a relatively short order and why
21 we suggested that the company file a general rate case
22 very soon with an interim rate request where they could
23 show on their -- having their own full level of
24 knowledge that they should deserve interim rates.

25 Q. So your proposal in this case is that they be

00660

1 given a surcharge prior to making that showing?

2 A. Yes, we're basically spotting them 90 days.

3 Q. Did your analysis take into account the \$60
4 Million in capital expenditure cuts to which Mr. Ely
5 testified yesterday?

6 A. I didn't have that knowledge at that time.

7 Q. So again, the one financial index upon which
8 you based your testimony was the fixed charge coverage
9 ratio, correct?

10 A. Yes.

11 Q. And if we go to page 18 of your testimony, at
12 lines 8 through 10, you say:

13 The main reason for this dramatic climb
14 in this measure, a fixed charge coverage
15 ratio, is the use of the revolving line
16 to finance the Coyote Springs II
17 project.

18 A. Yes.

19 Q. Now I realize that Mr. Van Cleve just touched
20 on this same ground. I take it though from your
21 testimony that if some other disposition was made of the
22 Coyote Springs project, presumably that would have a
23 beneficial effect, since you have identified this as the
24 main reason for the decline. Wouldn't that be fair to
25 say?

00661

1 A. Yes, and that beneficial effect could come
2 about if they were able to obtain public financings,
3 forward financing that doesn't count against the fixed
4 charge ratio. Selling it would be another probably more
5 drastic way to accomplish that.

6 Q. Or sell a part of Coyote Springs?

7 A. Sure.

8 MR. FFITCH: I don't have any other
9 questions, Your Honor, thank you.

10 JUDGE MOSS: Questions from the Bench.

11 CHAIRWOMAN SHOWALTER: I have just a couple.

12

13 E X A M I N A T I O N

14 BY CHAIRWOMAN SHOWALTER:

15 Q. If you could turn to your Exhibit 403.

16 A. Yes.

17 Q. Page two, as I understand it, this is a set
18 of calculations based on critical hydro year or critical
19 what is the question?

20 A. Return to the level of -- the planning level
21 of critical hydro that has been used by the Northwest
22 Power Counsel.

23 Q. Okay. As opposed to less --

24 A. As opposed --

25 Q. -- to be below critical, which is page one.

00662

1 A. Yes.
2 Q. Or for more normal --
3 A. Which is the company's --
4 Q. -- which is --
5 A. -- projection, yes, right.
6 Q. But focusing on page two, you get to an
7 ultimate calculation on line 17, the right-hand column,
8 of the surcharge indicated, and I'm trying to get a
9 sense of what other assumptions are implicit in this
10 page aside from assuming the critical water year, if I
11 have stated that term right. And in particular, on page
12 20 of your testimony, you say you are -- you assume
13 Avista is able to finance Coyote Springs and in that
14 Avista successfully issues 65 Million of common stock.
15 Are those two assumptions built into or assumed in this
16 page?
17 A. Yes, that's the same in the left-hand column,
18 the middle there, the 178,214.
19 Q. What, maybe you could tell me what line.
20 A. Line 19.
21 Q. Of the --
22 A. Of the draws under revolving credit line.
23 Q. Okay.
24 A. That's held constant in each of the
25 scenarios.

00663

1 Q. And so because that is held constant, what
2 are you assuming?

3 A. Simply the change in the amount of
4 hydrogeneration that's available. The company provided
5 worksheets that changed that assumption. The goal here
6 was to see if the changes in the hydro drove the fixed
7 charge ratio or not. And looking through each of the
8 assumptions, it didn't seem to make a big enough
9 difference to consider that in the -- as whether that
10 was a factor driving the fixed charge ratio to such low
11 levels.

12 Q. Okay. So that was the purpose, that was the
13 purpose of comparing pages one to two to three?

14 A. Yes.

15 Q. But then all of them or your analysis in
16 general makes the assumption that you state on page 20
17 as to the ability to finance Coyote Springs and the
18 ability to issue the common stock?

19 A. Yes.

20 Q. Okay. So my next question is, do you have an
21 opinion as to whether those two assumptions about Coyote
22 Springs, financing and issuing stock, are reasonable
23 assumptions if the Staff recommendation is adopted?

24 A. Taking the Staff recommendation as a whole
25 with the desire to wind up the deferral mechanism and

00664

1 determine its recoverability in the very near future,
2 and looking at the company showing its needs for interim
3 rate relief in the context of a general rate case, I
4 think all taken together, those items would show a
5 desire by the Staff to work with the company to solve
6 its problems, and that should go a long ways towards
7 allowing the company to present a positive picture to
8 the financial community, and therefore achieving its
9 financings.

10 Q. So that's the financing part. What about
11 issuing the common stock part?

12 A. I'm taking those together, yes.

13 Q. So is what makes the difference is that in
14 your judgment the Staff recommendation shows good faith
15 toward the company, and that should make the difference
16 to the financial world?

17 A. The good faith and the determination in the
18 near future of what is recoverable out of the deferrals
19 that have been incurred to date.

20 Q. So it's the promise or the expectation that
21 these matters will be determined in a relatively short
22 period of time that you think gives the financial
23 community comfort enough to make these two assumptions?

24 A. We would hope so.

25 Q. Well, I guess I'm asking you whether you

00665

1 think so. In other words, we have a number of
2 recommendations and options before us, and we will take
3 some kind of action, and it would be an adverse
4 consequence, I think everyone would agree, if the
5 company were say immediately downgraded. So it makes a
6 difference to me whether any given option is likely to
7 avoid that result or likely to cause that result.

8 A. That's true, it's difficult for us to judge
9 or guess what the rating agencies will do under any
10 given circumstance. The company's own proposal does not
11 provide them enough cash to meet their fixed charge
12 ratios and the covenants on some of their bonds. They
13 also need, as they have stated, a plan. And we think
14 their plan actually extends the uncertainties of the
15 recoverability for many more months than what we would
16 like to see happen. And therefore, I think the way the
17 company spins the Staff's plan and presents it to the
18 financial community can either make it happen or not
19 happen, the financings.

20 CHAIRWOMAN SHOWALTER: Thank you.

21 COMMISSIONER HEMSTAD: I think I will forgo
22 any questions.

23

24

25

00666

1 E X A M I N A T I O N

2 BY COMMISSIONER OSHIE:

3 Q. Mr. Schooley.

4 A. Yes, Mr. Oshie.

5 Q. Yes, would you please address the contingent
6 of Mr. Schoenbeck that approximately \$25.6 Million of
7 the deferred account should not be collected by Avista
8 based on his judgment and opinion that it had already
9 been taken into consideration in the weather
10 normalization computation?

11 A. Mr. Schoenbeck seems to have laid some cards
12 on the table now that we would be addressing in Phase
13 II. We certainly wouldn't contest that at this point.
14 We -- Staff's analysis may come up with a different
15 number. Mr. Schoenbeck says he thinks that would be a
16 reasonable number. He's somewhat confident that would
17 be the ultimate result, so he uses that number then to
18 make his further calculations.

19 THE WITNESS: Is that getting at your
20 question or --

21 COMMISSIONER OSHIE: Well, I think you have
22 answered it, yes.

23 JUDGE MOSS: Okay.

24 COMMISSIONER OSHIE: When it would be dealt
25 with, thank you.

00667

1 JUDGE MOSS: Anything essential, Mr. Meyer,
2 before I return to the redirect?

3 MR. MEYER: No.

4 JUDGE MOSS: Thank you.

5 Redirect.

6 MR. TROTTER: Thank you, Your Honor.

7

8 R E D I R E C T E X A M I N A T I O N

9 BY MR. TROTTER:

10 Q. Mr. Schooley, turn to your Exhibit 403, and
11 on -- you discuss this under line 19 on each page, the
12 financings leading to the \$178,214,000, and those are
13 the financings that you indicate that you assumed would
14 occur on page 20 of your testimony?

15 A. Yes.

16 Q. And is it your testimony that with the 32.6%
17 increase that Staff is proposing, that the company will
18 be able to do those financings?

19 A. Yes, we think the company would be able to do
20 those financings, as we think that the company's
21 assumptions are the same as ours, that they will be able
22 to complete those financings by the end of this year,
23 given a similar magnitude of surcharge.

24 Q. Public Counsel asked you whether you analyzed
25 the impact of some of the items identified by Mr. Ely

00668

1 yesterday on the record, and you were here yesterday?

2 A. Yes.

3 Q. Did you analyze the impact of the company's
4 ability to gain waivers of its financing covenants on
5 your recommendation?

6 A. I did not analyze that. I think the
7 assumption that they would be able to finance may have
8 that implicit in it.

9 Q. Did you consider the impact of any dividend
10 that might be issued from Avista Energy to Avista
11 Corporation?

12 A. No, I did not.

13 MR. TROTTER: Those are all my questions,
14 thank you.

15 JUDGE MOSS: Thank you, Mr. Trotter.

16 It would appear, Mr. Schooley, that your
17 tenure on the stand was brief, but enjoyable, I'm sure.

18 THE WITNESS: I demand my one hour.

19 JUDGE MOSS: You are released subject to
20 recall.

21 Why don't we bring Mr. Lott up and swear him
22 in and get through the preliminaries, and then we will
23 be ready to proceed through the cross-examination
24 promptly at 7:00 after we return from our dinner break.
25

00669

1 (The following exhibits were identified in
2 conjunction with the testimony of MERTON R. LOTT.)
3 Exhibit 501-T is Pre-filed Direct Testimony.
4 Exhibit 502 is MRL-2 Quotes from Avista SEC Filings.
5 Exhibit 503 is MRL-3 Staff's Open Meeting Memorandum in
6 Docket No. UE-000972 dated August 9, 2000. Exhibit 504
7 is MRL-4 Partial Transcript of WUTC Open Meeting of
8 August 9, 2000. Exhibit 505 is MRL-5 Avista SEC Form
9 10-Q for 3d Quarter 2000.

10

11 Whereupon,

12

MERTON R. LOTT,

13

having been first duly sworn, was called as a witness

14

herein and was examined and testified as follows:

15

16

JUDGE MOSS: Thank you, please be seated.

17

We're going to go through the preliminaries.

18

19

D I R E C T E X A M I N A T I O N

20

BY MR. TROTTER:

21

Mr. Lott, do you have before you Exhibit 501?

22

A. Not right at the moment, but I have it, and I
23 will.

24

JUDGE MOSS: I think he has it firmly enough

25

in mind for this purpose, Mr. Trotter, go ahead.

00670

1 MR. TROTTER: Thank you, I wasn't looking.

2 BY MR. TROTTER:

3 Q. Is Exhibit 501 your pre-filed direct
4 testimony?

5 A. Yes, it is.

6 Q. If I asked you the questions that appear
7 there, would you give the answers that appear there?

8 A. Yes.

9 Q. And do you sponsor four exhibits, Exhibits
10 502, 503, 504, and 505, correct?

11 A. Yes.

12 Q. With respect to the Exhibit 502, was that
13 prepared by you?

14 A. 502 is the transcript of the open meeting.

15 Q. It's the quotes from the Avista SEC filings?

16 A. Yes.

17 Q. Is that true and correct to the best of your
18 knowledge?

19 A. Yes.

20 Q. With respect to the Exhibit 503 and 505,
21 which are the open meeting memorandum and the form 10-K
22 and I believe 10-Q, are those correct copies of what
23 they purport to represent?

24 A. Yes.

25 Q. With respect to Exhibit 504, the partial

00671

1 transcript of the UTC open meeting on August 9, did you
2 compare the actual tape with that transcript?

3 A. I have listened to the tape while I was
4 reading the transcript, yes.

5 Q. And other than perhaps minor typos, is that
6 transcript correct for purposes of your use?

7 A. Generally speaking, I believe that most of it
8 is perfectly correct. There are a few examples such as
9 a reference to Commissioner Hemstad when it was
10 Commissioner Gillis in an early comment, but other than
11 that, the quotes are almost identical.

12 MR. TROTTER: I will move for the admission
13 of Exhibits 501 through 505.

14 JUDGE MOSS: Hearing no objection, those will
15 be admitted as marked.

16 And with that, the witness will be ready for
17 cross-examination at 7:00, and we will be in recess
18 until then.

19 (Dinner recess taken at 5:40 p.m.)

20

21 E V E N I N G S E S S I O N

22 (7:00 p.m.)

23 JUDGE MOSS: We swore Mr. Lott before the
24 break, and I believe we actually dispensed with the
25 preliminaries, and he's ready for cross-examination,

00672

1 Mr. Meyer.

2 MR. MEYER: Thank you, we have no questions
3 at this time.

4 JUDGE MOSS: All right, then that would lead
5 us to Mr. Van Cleve.

6 MR. VAN CLEVE: No questions, Your Honor.

7 JUDGE MOSS: And that would lead us to
8 Mr. ffitch.

9 MR. FFITCH: No questions, Your Honor.

10 JUDGE MOSS: And that would lead us to the
11 Bench.

12 CHAIRWOMAN SHOWALTER: I don't have any
13 questions, thank you.

14

15 E X A M I N A T I O N

16 BY COMMISSIONER HEMSTAD:

17 Q. Mr. Lott, I'm sure you have read the
18 testimony of Mr. Hoover.

19 A. Yes, I have.

20 Q. I take it or do I take your testimony to
21 conclude that the company improperly has accounted for
22 the deferrals as a regulatory asset?

23 A. Yes, my testimony deals with the company's
24 original treatment of the regulatory assets, I mean the
25 deferrals as regulatory assets. It's not necessarily a

00673

1 statement of whether they're regulatory assets today or
2 not, but it has to do with how the company originally
3 treated them on the books.

4 Q. All right. And how did they -- I have reread
5 the Staff memo, which was Exhibit 503, at the time this
6 was considered by the Commission, August 9, 2000, and so
7 how did the company treat the deferral initially?

8 A. On their September 10-Q from last year, the
9 company put the deferrals into their balance sheet and
10 therefore increased their income for that quarter. By
11 increasing their income and including the deferrals on
12 their books that they reported to the financial
13 community, they treated that as a regulatory asset under
14 generally accepted accounting principles. I think
15 Mr. Hoover has testified today that that's, in fact,
16 what they have done.

17 Q. My question I guess was misstated. I'm
18 looking at page two.

19 A. Of Mr. Hoover's or mine?

20 Q. No, of the Staff memo, Exhibit 503. I'm
21 trying to understand the circumstance as of that time.
22 And at the top, it's described there as proposed
23 accounting treatment, and Avista requests the following
24 specific accounting treatment and then described. Is
25 what they are describing there how the deferral would be

00674

1 treated on their regulatory books?

2 A. Yeah, the accounts that they talk there are
3 the accounts per the FERC system of accounts, and so
4 those are the accounts.

5 Q. And that's how the item would be treated in
6 their what, reports to FERC and --

7 A. Well, more importantly, their reports to this
8 Commission.

9 Q. And to this Commission, and they would be
10 treated there as debts; is that right?

11 A. They would be treated there as -- in the
12 reports to this Commission, we authorized them to put
13 these deferrals, therefore debits, onto their books in
14 account 186 and do the other accounting that's shown in
15 those reports, I mean on that sheet.

16 Q. And I guess I'm trying to understand then the
17 link. So when they're reporting to us, they are
18 reporting as a, well, as a miscellaneous deferred debt?

19 A. Debit, yeah.

20 Q. Debit.

21 A. Okay, there is a distinguishment, and as I
22 said, again, Mr. Hoover also stated that there is a
23 difference between the reports they submit to the
24 Commission and the accounting for Commission purposes,
25 which is not just under the FERC system of accounts.

00675

1 It's under what the Commission, you, approved them to
2 do. What's in generally accepted accounting principles,
3 those things to the general public, so those things that
4 are included in their annual report, the 10-K and the
5 10-Q, are following generally accepted accounting
6 principles.

7 The definition of -- well, first of all, if
8 you tell them to put a deferral on their books but don't
9 create a regulatory asset and that's the way you have
10 treated it, and that's what, if you read through that
11 memo and we can go through that, Staff distinguished
12 between a regulatory -- between account 182 and account
13 186 in that memo. And the intention was to identify the
14 difference between a regulatory asset and just a
15 deferral for future consideration of uncertainty.

16 Okay, and in generally accepted accounting
17 principles, however, there has to be, for them to record
18 them on the books, you know, to their stockholders, they
19 need to be able to meet the requirements of FAS 71. And
20 as Mr. Hoover said this morning, the two don't have --
21 two don't have to agree with each other. The company
22 could include something as a regulatory asset under
23 generally accepted accounting principle books that would
24 not show up on their reports to the Commission and visa
25 versa.

00676

1 Good example of one that is not on the
2 company's books is U.S. West or now Qwest does not show
3 their depreciation at the rates that this Commission or
4 other commissions set. They have gone out and done
5 financial institute and what they believe is the proper
6 depreciation for an unregulated company, and they show
7 their depreciation at that level, which is a lot greater
8 depreciation than what we have allowed them to take, and
9 therefore they have a lower net book value. They wrote
10 off that depreciation, because they did not believe they
11 met the requirements of FAS 71, those requirements that
12 Chairman Showalter was talking to Mr. Hoover about
13 earlier, the requirements of who is a regulated company.
14 So there is a difference in the books.

15 The -- I want to take you back, and it's also
16 in my testimony, the discussion about regulatory assets.
17 The FERC system of accounts does describe what a
18 regulatory asset is, and that is quoted in my testimony,
19 and it's a fairly similar definition. It's not
20 identical. It's a fairly similar definition to what
21 FAS, you know, the generally accepted accounting
22 principles definition is. And I just want to
23 distinguish that there is what we have told them to put
24 in their books, and then there's what's generally
25 accepted accounting principles.

00677

1 And I'm saying that we did not create a
2 regulatory asset, but that does not mean that we did not
3 tell them to put it on their books. And at the same
4 time, however, I do not believe, especially after
5 listening to the trans -- well, I was in the room when
6 it was approved last year, and then listening to the
7 transcripts subsequent to that, there's no question in
8 my mind that the contingencies that this Commission put
9 on that should not have allowed the company to book this
10 in the generally accepted accounting principles, I mean
11 as a regulatory asset.

12 Q. And from your testimony, again just simply
13 the history, did the company request that the Commission
14 treat it as a regulatory asset?

15 A. The company's original petition last, well,
16 it was in June, it was approved in July, yes, they did
17 ask for a regulatory asset.

18 Q. And our ultimate order did not do that?

19 A. Does not say that it's a regulatory asset,
20 that's correct.

21 Q. Well, would it be your view that the
22 company's treatment of this was misleading?

23 A. Yes, I believe that it's miss -- their
24 representation last year was misleading.

25 Q. I listened to the further testimony this

00678

1 morning. In your view, how should the company have
2 treated this, not on its regulatory books, but in its
3 report to the public and the shareholders and the like?

4 A. During the year 2000, I do not believe this
5 item should have been included as a regulatory asset.
6 Therefore, it should not have been included as an asset
7 on the company's --

8 Q. What would they do with it on their books?

9 A. They would have just expensed it, and
10 therefore their retained earnings would have been lower
11 at the end of the year. There may have been comments.
12 You said, what would they do in their financial
13 statements, there may have been a discussion about these
14 deferrals, about the company's intent to try to recover
15 these deferrals in future proceedings, but I do not
16 believe the amounts of those would show up in the
17 financial statement.

18 Q. Well, I'm looking at the last sentence in the
19 Staff memo on page four, again that's Exhibit 503, which
20 directs the company to include a footnote in regulatory
21 reporting or in financial disclosure statements. Did it
22 do that on its financial disclosure statements?

23 A. It did have a footnote, although the footnote
24 in the 10-Q I think was incomplete, because it didn't
25 refer to the appropriateness in the first place. But I

00679

1 do not even believe that it should have been there in
2 the first place. This says that in those financial
3 statements that are there, that it's included, it
4 should. It does not say that they should record it
5 there. If you read it, it just says -- I'm looking at
6 the wrong place, I'm sorry, is required to include a
7 footnote in all regulatory reporting or financial
8 disclosure statements that include these deferrals. So
9 if the deferrals are included in a statement, they are
10 required to put the reports. That does not mean that
11 these things are regulatory assets.

12 Q. But so in conclusion, it would be, is it fair
13 to say, it would be your view that by treating the item
14 as a regulatory asset, the company's books look
15 substantially better than they otherwise should have?

16 A. The company, yes, the company's books create
17 a presumption of recovery that is directly opposed to
18 the statements made by Mr. Van Cleve, by Matt
19 Steuerwalt, the Chairman Showalter and by yourself
20 during that meeting.

21 COMMISSIONER HEMSTAD: I don't have any
22 further questions.

23 CHAIRWOMAN SHOWALTER: Well, I would like to
24 follow up on that.
25

00680

1 E X A M I N A T I O N

2 BY CHAIRWOMAN SHOWALTER:

3 Q. First of all, is it your opinion -- in your
4 opinion, is the company today violating any Commission
5 order with respect to this subject?

6 A. The Commission order simply says that they're
7 supposed to put a disclosure.

8 Q. I'm talking about a --

9 A. So my answer is I would say the simple answer
10 would be no. The order says that they're supposed to
11 put this footnote if it's included in the financial
12 statement.

13 Q. Which order are you talking about?

14 A. The one from August 9th or the one from
15 January 24th, either one.

16 Q. Use the years, please.

17 A. Sorry, that's -- make sure I got the right
18 year -- August 9th, 2000, and January 24th, 2001.

19 Q. What order or orders are currently in effect
20 today regarding how this is treated in accounting or for
21 accounting purposes?

22 A. I guess one of the problems is you're asking
23 me to talk about an order that I'm not extremely
24 familiar with. My testimony was dealing with the
25 original pronouncements by this Commission, which would

00681

1 be the August 9th and the January 24th orders. There
2 was an order related to the settlement that the parties
3 provided, and I would assume that would be a
4 continuation of the previous ones. But the honest truth
5 is I did not participate in that proceeding.

6 CHAIRWOMAN SHOWALTER: Just as an aside, I
7 would find it very helpful to have orders as exhibits,
8 because you then know where to find them, and I went and
9 retrieved a few orders, but not --

10 JUDGE MOSS: The orders pertinent to this, I
11 believe, are exhibits to Mr. Elgin's testimony.

12 CHAIRWOMAN SHOWALTER: Okay.

13 JUDGE MOSS: And I believe the August 9th
14 order is Exhibit 454, and the January 24th, 2001, order
15 is Exhibit 456.

16 THE WITNESS: Judge Moss, but there would be
17 the order on the stipulation or settlement from the
18 March filing.

19 CHAIRWOMAN SHOWALTER: And I do happen to
20 have that order.

21 THE WITNESS: That's the one I'm not familiar
22 with.

23 JUDGE MOSS: That's also an Exhibit Number 1.
24 Well, that's the settlement stipulation. It may not
25 have the order attached to it.

00682

1 BY CHAIRWOMAN SHOWALTER:

2 Q. All right, I'm going to work backwards. On
3 May 23, 2001, we issued the First Supplemental Order
4 approving and adopting the settlement stipulation in
5 this case. And among other things, it orders that the
6 existing amortization approved in Docket 00972 is no
7 longer necessary and is no longer required. Does that
8 affect this discussion?

9 A. The amortization, no.

10 Q. Okay. What I'm struggling with is what of
11 our orders are currently in effect, and what may have
12 amended a previous one. And believe me, I don't know
13 the answer at this moment. But the more general
14 question is, did the May 23, 2001, order change anything
15 about how this would be treated either as a regulatory
16 asset or in how it's accounted for?

17 A. My understanding of the May 23rd order, and
18 by the way I don't have a copy of it here, and what
19 happened, that's the acceptance of the stipulation. The
20 stipulation allowed the company, I guess this is
21 amortization, but to amortize off the deferral to the
22 extent -- I mean to let the deferral run, and then after
23 a period of time, the deferral would go away. And the
24 company agreed that -- I mean they had the right to come
25 back in for, for example, this proceeding that we're in

00683

1 front of here today, but -- and at the end of that
2 period of time, the deferral balance was to be set at
3 zero, I mean was to go to zero. That's my understanding
4 of that order. That does not set or provide any revenue
5 to the company in a rate order. It doesn't meet the
6 requirements of FAS 71. It just simply says we're going
7 to ignore this, and if this thing goes away, it goes
8 away. If it doesn't, you're going to come back in and
9 ask for something else.

10 Q. Okay.

11 A. And they're back in asking for something
12 else.

13 Q. All right, let me turn then back to the
14 August 9th, 2000, order, which is Exhibit 454. Is there
15 anywhere in the order where we constrain or direct the
16 company how to reflect this on its books?

17 A. Do you tell them how to reflect it on their
18 books?

19 Q. Mm-hm.

20 A. You allow them to defer the amount, and, of
21 course, your orders tell them how to report to this
22 Commission. So you have ordered them to report to this
23 Commission this deferral.

24 Q. All right. Now but then there is GAAP, and
25 we had some discussion of that, and my understanding of

00684

1 the earlier discussion, and you can add to the
2 discussion, is that this Commission can approve a
3 deferred accounting mechanism on its own terms and
4 require reports to the Commission on its own terms and
5 importantly can state in its order and has every time,
6 this does not create a presumption as to the ultimate
7 recoverability or prudence of these activities. And
8 that's what we have to say about the matter.

9 But on the other hand, it was -- it's my
10 impression from the discussion earlier in the day that
11 others under GAAP can make a judgment about
12 recoverability that may not be the same as our lack of
13 presumption. In other words, the testimony was that the
14 company or a bank or an accounting firm can make its own
15 judgment under GAAP and decide to reflect the expenses
16 or the revenue or whatever is being shown according to
17 its judgment about what we will do.

18 And so the difference is you may have an
19 opinion, we may have no opinion, officially we have no
20 opinion, Mr. Schoenbeck may have a tentative opinion
21 about recoverability, and so does the company or the
22 bankers may have an opinion. But if they have a
23 different opinion, that doesn't mean that the company
24 has, number one, violated our order, and the discussion
25 I heard, it also doesn't mean they violated GAAP. So

00685

1 where in that train of thought do you disagree, if you
2 do?

3 A. Okay, I agree with what Mr. Hoover's
4 statements were. I agree with Mr. Hoover on almost
5 everything he has said except for two areas. I'm first
6 of all going to give you one area so that you understand
7 a slight clarification. It has to do with a statement
8 that he made in response to Judge Moss's question, and
9 that is the definition of probable and how accountants,
10 you know, you were asking about is there kinds of levels
11 of things, and he referred to FAS 5, and he gave you an
12 example on FAS 5. The difference in FAS 5 is it's
13 defined in FAS 5.

14 The definition, however, and I think
15 Mr. Falkner and I have both said the same thing,
16 although he has used the definition that's written in
17 FAS 71 out of a dictionary, and I used my dictionary,
18 they both say the same thing. FASB 71 is based on
19 probable as defined in the dictionary, standard
20 definition. It's not something special. It's not going
21 to what accountants think. It goes to what the word
22 probable means to people. It's a general definition.
23 And that's important, because what's -- FAS 5 is not
24 that. They define three levels, and probable is one of
25 those three levels. And so in that case, they do have

00686

1 those levels.

2 Now the other area that I disagree with

3 Mr. --

4 Q. Well, wait, I didn't understand. I want to
5 make sure I understand what you're saying. If Mr. Ely
6 thinks it's probable that he and his company will
7 recover, is that good enough? Let's say he's got a
8 third party auditor along with him, has the company
9 violated GAAP in your opinion?

10 A. The reports are designed for financial
11 people, for analysts. Financial Accounting Standards
12 Boards was designed to create reports, not for
13 accountants, but for people that used accounting
14 statements. They went from the accounting principles
15 board to FASB to achieve that goal. That's why they
16 renamed the financial that way so that it would be more
17 than accounting, it would be something that people could
18 use. So if Mr. Ely represents what typical financial
19 analysts would view, then yes. But if Mr. Ely is the
20 extreme at one end, and he says, yeah, that's good, then
21 no. Again, there --

22 Q. Well, in this instance, are you saying that
23 the company has violated GAAP principles?

24 A. I believe so, yeah.

25 Q. All right.

00687

1 A. At least during the year 2000.

2 Q. Well, today, as of today, I mean we have to
3 deal with today.

4 A. Well --

5 Q. Are they in violation of GAAP principles
6 today, in your opinion?

7 A. Today?

8 Q. Yes.

9 A. I think they have created a regulatory -- I
10 think there's a good chance that they have created a
11 regulatory asset by their actions, not necessarily.

12 Q. How did they create a regulatory asset, I
13 thought we created --

14 A. A creative pre -- you don't create a
15 regulatory asset. Regulatory assets are something that
16 are probable of being recovered in revenue. And by
17 creating the belief, the presumption in people's mind
18 that this is going to be recovered, I believe that the
19 company has participated in -- now there's some other
20 factors that go into that. The size of the item itself
21 becomes so large that -- and that's obviously why the
22 company believes that it is recoverable is this has
23 become a very large item. And as the item grows larger
24 and larger, the Commission has a very hard time in
25 letting the company die.

00688

1 Now if the company chose a route they decided
2 to book it, therefore they thought they could wait and
3 deal with this sometime in the future. But by creating
4 what I don't believe was a regulatory asset and putting
5 it onto their books as a regulatory asset, then the
6 amount grew, the presumption now may be different than
7 the presumption should have been a year ago or ten
8 months ago. I don't disagree. I mean to me it's very
9 logical that a very large portion of this is going to be
10 recoverable.

11 I would question whether 100% of this item
12 should be treated as a regulatory asset, because there's
13 some -- you heard Mr. Schoenbeck's, you know, viewpoints
14 today, and Staff is going to come up not necessarily
15 just on the prudence issue, but Staff is going to have
16 to deal with the appropriateness of the full recovery
17 and the full amount, and there's going to be some items
18 there that are very questionable.

19 But as this amount grows, the company would
20 have dealt with this in a different fashion if it had
21 not been on their books as a regulatory asset. They
22 would have had to find some other way to deal with these
23 large deferrals, and then this Commission wouldn't have
24 had to react. But because they put it as a regulatory
25 asset and then let it ride, the numbers become so large

00689

1 you will react in this docket to that problem, so there
2 is a substantial amount of regulatory asset in my
3 viewpoint within those deferrals today. I don't believe
4 that was true a year ago, but I believe it's true today
5 because the number is so large.

6 Q. Can I ask you to keep your answers short.
7 They really do go on a long time, and I try to keep my
8 own train of thought going.

9 A. I will try.

10 Q. Let's take not a large amount, but a small
11 amount, so that the large coercive factor that you're
12 citing is not a factor.

13 A. So stay with the \$20 Million the company
14 projected?

15 Q. Yeah. So let's say in that instance, if we
16 had approved a deferred accounting treatment, but we had
17 said expressly, this is not -- this does not create any
18 presumption about prudence or ultimate recoverability,
19 and then the company in its own judgment decided that
20 they felt they would probably recover the \$20 Million,
21 is that, in your view, is that a violation of GAAP
22 principles?

23 A. You have to look at all the factors, and it
24 wouldn't just be the Commission saying we're not going
25 to make a presumption one way or the other. It's the

00690

1 fact that the Commission said that in response to two
2 people, Mr. Van Cleve and Mr. Steuerwalt, that we're
3 saying, you shouldn't create this thing. We don't
4 believe that the deferral --

5 Q. Let's stick to what the order says, the
6 written order says. Assume the written order says
7 there's no presumption by the Commission itself of
8 unrecoverability. The question I have is, in your view
9 under GAAP, is a company or a bank or the company's
10 financial advisors allowed to make its own judgment,
11 which may be more positive, a more positive judgment
12 than the Commission at that moment in its order
13 reflects, because the Commission at that moment is not
14 making a judgment and is not making a presumption, do
15 you think that GAAP allows for the educated guess or the
16 judgment about recoverability?

17 A. GAAP allows, like Mr. Hoover said, the
18 company and the auditor to look at other factors, and
19 that's what I'm referring to. Mr. Hoover said what
20 factors he looked at. Those factors are not the factors
21 that I would have looked at in isolation. But what this
22 Commission had done in the past, what was said when they
23 did this thing, what their attitudes were towards
24 deferrals in previous proceedings, those all would make
25 a difference.

00691

1 Q. Okay. So if they made the wrong judgment at
2 the time, in other words, they really should not have
3 made a judgment that this amount was recoverable, but
4 mistakenly they did make that judgment, then what; what
5 is the consequence that we deal with?

6 A. What is the consequences that you as the
7 Commissioners deal with?

8 Q. Yeah, what is within my authority as a
9 commissioner or what is in our authority as a Commission
10 to do about that fact?

11 A. Your authority is just -- is just to make
12 your decision based on the reasoning that you have
13 today, and that has nothing to do with whether you
14 approved the deferral on August 9th just as a tracking
15 mechanism. You still have the complete authority to
16 allow them 100% recovery of that with interest. You
17 have authority to say no for any one of the reasons that
18 you cited in your original order, which includes the
19 three, the prudence, second prudence item in there,
20 appropriateness of doing this, along with the other type
21 of items that you included in your January 24th order,
22 which spelled out the requirements for a PCA, which came
23 from a previous proceeding.

24 Q. But if the company mistakenly reflected this
25 on its books under GAAP, mistakenly meaning misguidedly

00692

1 did, what is it today that we do about that fact, that
2 past fact?

3 A. What is it today that you do about that past
4 fact?

5 Q. Yeah, in other words, here we are today, and
6 we will issue an order of some kind that will grant or
7 not grant some measure of relief over some period of
8 time, et cetera. So maybe the question is why are we
9 talking about --

10 MR. MEYER: Yeah.

11 Q. -- whether in 2000 they did or didn't follow
12 GAAP in your opinion? How does it relate up to what our
13 action is?

14 A. What your actions are today and what your
15 actions may be in the future, you made a decision a year
16 ago to allow somebody to do something. They carried --
17 they might have done it in a different fashion than you
18 want, and now that decision is coming back to pressure
19 you to do something. And whether you do it or not, but
20 it's still there, it's a pressure. You have this
21 concern out there about how much money can this company
22 absorb, whether this is the right proceeding or the
23 right way to deal with these high power costs.

24 Does it affect the decision you make today?
25 I have a hard time really trying to identify that. I

00693

1 was asked to testify on whether this was a regulatory
2 asset, if it becomes a regulatory asset. My conclusion
3 is it was not a regulatory asset last year. It's quite
4 likely that a substantial portion is a regulatory asset
5 today. It's quite probable, very probable that a large
6 portion of this item will be recovered in some form
7 going into the future.

8 My point is that you made a decision a year
9 ago that all of a sudden you have -- it has changed, and
10 I guess from my standpoint, it's be careful in the
11 future on that type of -- that type of process. Make
12 sure that when you allow a deferral, you really mean
13 that you want to create a deferral.

14 But as far as your decision here, you have to
15 make a decision whether the company should be allowed to
16 recover these power costs. You have previously stated
17 that you want a prudence review of those costs before
18 you do that and an appropriateness review before you do
19 that. But when the company needs emergency relief, it
20 becomes a totally separate question. In other words is
21 the company in such bad shape financially that they need
22 a rate relief, this is really not an issue to that fact,
23 I mean to that question.

24 Q. Okay, but then isn't it --

25 A. In my mind, I mean.

00694

1 Q. Then we are here though on the emergency
2 request.

3 A. Yes, and Staff is recommending an emergency
4 relief too.

5 Q. But I guess I thought that one of the reasons
6 for Staff's recommendation had -- has to do with how
7 this is reflected on the books. I thought we heard from
8 Ken Elgin that the reason we need to hurry up, we can
9 only give 90 days, and then we've got to hurry up in 90
10 days to resolve prudence is so that before the end of
11 the year, we get it all squared away and can essentially
12 correct or get a correct GAAP statement.

13 A. Well, the company's bankers are coming down
14 to the same conclusion that Staff had originally. There
15 is a question about the recovery of these deferrals.
16 The problem that you have here is a company that has a
17 large asset on their books that there's -- when you read
18 transcripts and when you look at how it was created,
19 there's a large amount of uncertainty. Ken testified
20 that he wanted, Mr. Elgin, sorry, testified that he
21 wanted to eliminate that uncertainty, and that makes a
22 lot of sense. Let's get rid of the uncertainty.

23 That deals with prudence, and that deals with
24 the appropriateness of doing this, and establish whether
25 there is a regulatory asset there or not and whether the

00695

1 company should be allowed to recover that in the future.
2 And there still would be a question then of whether this
3 -- of whether this is recovery of that deferral or
4 whether this surcharge is just revenue in the company's
5 pocket or possibly I guess refunded to the customers.
6 But I mean that would be a future decision also.

7 CHAIRWOMAN SHOWALTER: I have no further
8 questions, thank you.

9 COMMISSIONER HEMSTAD: I have one further.

10

11 E X A M I N A T I O N

12 BY COMMISSIONER HEMSTAD:

13 Q. Has the Commission in the past from time to
14 time directed the creation of regulatory assets?

15 A. Has the Commission?

16 Q. Yes.

17 A. Yes, numerous times. Last winter for this
18 same company, they came in with a request on FAS 133 and
19 138 requesting that we treat it basically not according
20 to the new FAS 133 and 138, but stick with the old style
21 of accounting, which would create either regulatory
22 assets or liabilities on their books, depending on which
23 way things flowed, and this Commission said yes, do
24 that, and approved that. I mean there's numerous ones
25 like that.

00696

1 Q. And with that direction, the company would
2 then have the confidence, it could describe that in its
3 financial statements knowing that it had the support of
4 the Commission?

5 A. Right.

6 COMMISSIONER HEMSTAD: That's all I have.

7

8

E X A M I N A T I O N

9 BY JUDGE MOSS:

10 Q. Mr. Lott, a couple of questions were deferred
11 to you, and I want to be sure that I have the answers if
12 you can give them to me. One is, what is a side record?

13 A. Watch out, there's side records that mean
14 different things. The side record that Mr. Elgin refers
15 to is just simply what I would have called a tracking
16 mechanism for the deferrals. That's what I heard was
17 approved last year. In other words, yes, we want to
18 keep track of this. Mr. Gillis and Mr. Hemstad were
19 talking about wanting to have information, so keep the
20 numbers off the books, but keep track of them, and you
21 have the right to bring them back. That's what the
22 Commission said.

23 It scared me when he asked -- when he said to
24 pass that question to me, but we went and found it in
25 the 86-131, the Commission related to WNP-3, they were

00697

1 trying to transfer this to a company called Puget
2 Energy, not the same Puget Energy as we have today, but
3 they were trying to transfer it to a subsidiary.
4 Commission rejected that and told them they could keep
5 the capital costs on the side record for possible future
6 recovery.

7 Q. And how is that different from a deferral
8 account? I thought you just said it was the same thing,
9 you said what you thought this Commission did when we
10 approved this mechanism.

11 A. I thought this Commission gave the company
12 the right to track these costs and bring them back for
13 discussion of prudence, you know, appropriateness of
14 using their, you know, their, I'm trying to remember the
15 second one, and for the appropriateness of recovering
16 this through some type of deferral mechanism and how
17 that, you know. But what the Commission gave them was
18 just simply -- many times Chairwoman Showalter kept
19 saying, all we're doing is tracking this, and that's
20 what a side record is typically used for. We put it in
21 account 186, but the transcript of that meeting clearly
22 indicates that all we were trying to do was track those
23 things. That's what the side record was done back in
24 U-86-131. That's probably the only place I have heard
25 side record referred to in that context.

00698

1 Usually the side records that I have heard
2 were related to FERC system, I mean not FERC, but SEC
3 system of accounts, where we told the company to do
4 something that SEC -- SEC would not allow them to put it
5 on their books, so they created a side record. That's a
6 different type of side record.

7 Q. I'm beginning to believe based on your
8 testimony that we're really just talking about labels.
9 Now maybe labels are important. I'm sure in some
10 instances they are. But it seems to me now as I reflect
11 on your testimony and Staff's position in the case, that
12 Staff is saying on the one hand, end the deferral as of
13 June 30th, 2001. But if you want to, Commission, create
14 this side record that will allow them to keep separate
15 track of these costs and later come back to you and seek
16 their recovery. Have I got it about right?

17 A. That's what I heard Mr. Elgin say too, so.

18 Q. Okay.

19 A. The answer would be yes.

20 Q. All right. And the other question he
21 deferred to you was I put to him the question of whether
22 this Commission had any direct authority with respect to
23 the financial accounting records that the company keeps
24 as opposed to the regulatory accounting records over
25 which it does have more or less plenary control.

00699

1 A. It does not have direct control. I'm just
2 trying to think. Obviously the orders of this
3 Commission greatly impact how the company would show
4 various items on their books. Depending on how detailed
5 the reports were, we might be able to, for example, have
6 them separate assets, you know, in a different way than
7 what they had previously recorded them. We ordered
8 them, for example, to include footnote if they put that
9 balance in their report. And so to that extent, we
10 could affect footnotes. But generally accepted
11 accounting principles are run their own -- by their own
12 requirements.

13 Q. And if the company runs afoul of those
14 requirements in its reports to the Securities and
15 Exchange Commission, it can probably expect to hear from
16 the Securities and Exchange Commission about that as
17 opposed to this Commission?

18 A. They would probably not hear from the
19 Securities and Exchange too often. They probably hear
20 from some upset stockholder when they weren't allowed to
21 recover something that was appropriate.

22 Q. That would be a shareholder derivative suit,
23 for example, if it turned out that a shareholder who
24 invested \$100 Million in this company discovered that
25 this was not really an asset?

00700

1 A. Yeah, I'm part of a couple of those joint
2 actions suits myself, so.

3 JUDGE MOSS: I think that's all I have.

4 MR. VAN CLEVE: Your Honor, can I ask just
5 one follow up on your question?

6 JUDGE MOSS: Oh, sure.

7 MR. VAN CLEVE: Thank you.

8

9 R E C R O S S - E X A M I N A T I O N

10 BY MR. VAN CLEVE:

11 Q. Mr. Lott, would it be fair to say that the
12 Staff believes that the company should be able to
13 continue to track these costs after the end of June
14 2001, but what you oppose is the company continuing to
15 treat these costs as a regulatory asset on its balance
16 sheet after June of 2001?

17 A. Again, Mr. Elgin said something up here, and
18 my understanding is is that he's saying that they could
19 bring any of these excess power supply costs back to the
20 Commission sometime in the future and try to recover
21 them. And there's they can track them, but that there
22 would be no deferrals on their books, and their records
23 should not indicate that there was a deferral.

24 Q. But what you're trying to cut off is --

25 A. But I'm not the Staff member that -- I did

00701

1 not propose that myself.

2 Q. Right.

3 A. So you should have been asking Mr. Elgin.

4 Q. But what you're trying to cut off as of that
5 date in the end of June is the continued treatment of
6 those costs as an asset, as a regulatory asset on the
7 company's books; is that right?

8 A. Again, I'm not 100% sure they were a
9 regulatory asset as of June 30th, but to stop showing
10 them on the books, any additional deferrals on the
11 regulatory books after that date.

12 MR. VAN CLEVE: Thank you.

13 MR. MEYER: I do have a follow on cross
14 question.

15 JUDGE MOSS: We're feeling very liberal
16 tonight.

17 MR. MEYER: Okay, thanks.

18 JUDGE MOSS: Just go right ahead.

19 MR. MEYER: Take full advantage of it then.

20 MR. FFITCH: Your Honor, may I interject with
21 counsel's indulgence?

22 JUDGE MOSS: You want to go first before him?

23 MR. FFITCH: I have a request.

24 JUDGE MOSS: Everybody waived their cross,
25 so.

00702

1 MR. FFITCH: I have a request in response to
2 the Chairwoman's questions, and I'm not sure if you will
3 entertain this, but she had some questions about order
4 provisions and effectiveness in this docket. And I was
5 prepared to request official notice of a provision that
6 I think answered one of her questions. In the first
7 supplemental order in this docket, the order of May
8 23rd.

9 CHAIRWOMAN SHOWALTER: Is that an exhibit in
10 here, in this case?

11 MR. FFITCH: I couldn't tell.

12 CHAIRWOMAN SHOWALTER: Oh, the May 23rd,
13 2001?

14 MR. FFITCH: 2001 order.

15 CHAIRWOMAN SHOWALTER: Yes, all right, well,
16 that's not an exhibit in this case. I happen to have
17 it.

18 MR. TROTTER: Your Honor, that was an exhibit
19 for Mr. Elgin identified as his Exhibit 457. We thought
20 there was a duplication, but maybe there wasn't in
21 hindsight.

22 JUDGE MOSS: Well, we have it here before us,
23 and that's all that matters for the reference. I
24 appreciate that, you're correct about that. It is not
25 an exhibit, however, because I eliminated that exhibit.

00703

1 But we have it here for purposes of questions, and if
2 Mr. ffitch wants to point the Chairwoman to something in
3 that order to answer one of her questions, I invite him
4 to do so.

5 MR. FFITCH: Thank you, Your Honor. I would
6 like to direct the Bench's attention to Paragraph 30 of
7 the order of October, October, where did that come from,
8 May 23rd, 2001, in this docket.

9 CHAIRWOMAN SHOWALTER: Which says that the
10 Commission orders further that it retains jurisdiction
11 to enforce the terms of this order and all prior orders
12 entered in this proceeding. So is that what you wanted
13 to draw to my attention?

14 MR. FFITCH: Yes. You had been asking about
15 whether prior orders in the proceeding, as I understood
16 your question, whether they retained in effect any
17 force.

18 CHAIRWOMAN SHOWALTER: Well, actually, my
19 question really was whether any later orders amended,
20 altered earlier orders. I think I assumed that if they
21 hadn't, then other ones wouldn't be affected.

22 MR. FFITCH: I perhaps misunderstood your
23 question. I thought this might be helpful.

24 JUDGE MOSS: Thank you, Mr. ffitch.
25 Mr. Meyer, you had a question?

00704

1

2

C R O S S - E X A M I N A T I O N

3

BY MR. MEYER:

4

Q. I do. Chairwoman Showalter asked, I won't probably rephrase this as artfully, but essentially, Mr. Lott, why are we discussing this issue at this time in this proceeding. May I direct your attention to page six of your own testimony.

8

9

CHAIRWOMAN SHOWALTER: What exhibit is that?

10

11

BY MR. MEYER:

12

Q. The Q and A, and I will read it aloud for emphasis, beginning at line 9:

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Question: Did Avista's June 23, 2000, petition in Docket Number UE-000972 also request that the Commission permit the company to create the power cost deferrals as regulatory assets under FAS 71?

Answer: No, such a request would not have been meaningful. This Commission has no authority or power to unilaterally establish regulatory assets under generally accepted accounting principles, GAAP. Whether a regulatory

00705

1 asset is created depends on whether FAS
2 71 applies, considering the Commission
3 actions, and all other relevant factors.
4 Was that your testimony?

5 A. Yes.

6 Q. Thank you. Now let's talk a little bit about
7 the tracking mechanism just so we're clear on that. And
8 I don't sense that you personally are here in favor of
9 or supporting such an alternative as a tracking
10 mechanism, correct?

11 A. I'm not here to talk about the merits of
12 recovery of the deferral at all.

13 Q. Okay. Would a tracking mechanism as you have
14 explored, even though you may not be recommending it, if
15 in place, would it have allowed the company to continue
16 to defer these costs?

17 A. No.

18 Q. So then the company would have --

19 A. Wait, wait, sorry, Mr. Meyer, maybe -- are we
20 talking about the tracking thing last August that the
21 Commissioners put out an order on or the tracking that
22 we were talking about from Mr. Elgin's testimony?

23 Q. From Mr. Elgin's testimony, would such a
24 tracking mechanism "off the books" I think as you may
25 have characterized it, would that have allowed the

00706

1 company to continue to defer costs, or would the company
2 nevertheless have to expense such costs?

3 A. They would have had to expense them.

4 Q. I see. So those costs month to month would
5 be expensed on the books of the companies, on the books
6 of the company, correct?

7 A. Correct.

8 MR. MEYER: That's all I have, thanks.

9 MR. TROTTER: Thank you, Your Honor.

10

11 R E D I R E C T E X A M I N A T I O N

12 BY MR. TROTTER:

13 Q. Mr. Lott, could you turn to page five of your
14 testimony. You were asked some questions about auditors
15 and others making their own judgment about whether FAS
16 71 applied and a regulatory asset was created; do you
17 recall those questions?

18 A. Yes.

19 Q. And just turning your attention to line six
20 on page five where you quote FAS 71 or a portion of it,
21 does that require that any such judgment be based on
22 available evidence?

23 A. Yes, it does.

24 Q. Did you express a concern in your testimony
25 here tonight regarding the evidence that Mr. Hoover

00707

1 considered?

2 A. Yes, I am expressing that, and my testimony
3 also expresses that belief.

4 MR. TROTTER: Nothing further, thank you.

5 JUDGE MOSS: It would appear to conclude our
6 questioning of Mr. Lott. We appreciate you being here
7 this evening and staying over with us, and you are
8 released subject to recall, as the other witnesses have
9 been.

10 THE WITNESS: Thank you.

11 JUDGE MOSS: Call your next witness.

12 MR. THOMPSON: Staff calls to the stand
13 Mr. Michael Parvinen.

14 JUDGE MOSS: And, Mr. Trotter, are you rising
15 to stretch your legs?

16 MR. TROTTER: Yes.

17 JUDGE MOSS: Okay.

18 MR. TROTTER: Mr. Thompson will handle it.

19 JUDGE MOSS: A new voice.

20

21 (The following exhibits were identified in
22 conjunction with the testimony of MICHAEL P. PARVINEN.)

23 Exhibit 551-T is Pre-filed Direct Testimony.

24 Exhibit 552 is MPP-2 Surcharge Rate Design Based on 2000
25 Pro Forma Revenue.

00708

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2 Whereupon,

3

MICHAEL P. PARVINEN,

4 having been first duly sworn, was called as a witness

5 herein and was examined and testified as follows:

6

7

D I R E C T E X A M I N A T I O N

8

BY MR. THOMPSON:

9

10 Q. Mr. Parvinen, did you prepare what have been
11 pre-marked as Exhibit 551-T, being your pre-filed direct
12 testimony, and 552, being your exhibit to that
13 testimony?

13

A. Yes.

14

Q. Are there any changes or corrections --

15

A. Yes.

16

Q. -- that you wish to make to either of those?

17

A. Yes, there are.

18

Q. Could you explain those, please.

19

A. I note one change on page seven of the
20 testimony, line ten, that I would note on Docket U-7357
21 when I was reviewing the custom -- these orders, that
22 the commercial customers in this case were given a
23 percentage equal to the increase to residential
24 customers. And then from that point, all schedules were
25 given a uniform cents per kwh.

00709

1 Q. So that would represent an exception to
2 the --

3 A. Yes, it would.

4 Q. -- statement being -- okay. With that
5 correction, if I were to ask you the questions in your
6 pre-filed testimony today, would the answers be the
7 same?

8 A. Yes, they would.

9 Q. And the exhibit designated 552 is true and
10 correct to the best of your knowledge?

11 A. Yes, it is.

12 MR. THOMPSON: Your Honor, I would offer
13 Exhibits 551-T and 552 for admission.

14 JUDGE MOSS: Hearing no objection --

15 MR. FFITCH: Objection.

16 JUDGE MOSS: I'm sorry?

17 MR. FFITCH: I'm sorry, Your Honor, the
18 objection is withdrawn.

19 JUDGE MOSS: Trying to keep me on my toes,
20 Mr. ffitch?

21 There being no objection, they will be
22 admitted as marked.

23 MR. THOMPSON: The witness is available for
24 cross-examination.

25 JUDGE MOSS: All right.

00710

1 Mr. Meyer.
2 MR. MEYER: I will pass for now, please.
3 JUDGE MOSS: Mr. Van Cleve.
4 MR. VAN CLEVE: No questions, Your Honor.
5 MR. FFITCH: I just have one question. Thank
6 you, Your Honor.

7
8 C R O S S - E X A M I N A T I O N
9 BY MR. FFITCH:

10 Q. Good evening, Mr. Parvinen.
11 A. Good evening, Mr. ffitch.
12 Q. Could you compare your accounting, how your
13 accounting of revenues can be used to satisfy the
14 covenants compared to the company's?
15 A. Yes. The best place to show this would be to
16 look at what's been marked as an Exhibit 210, or it is
17 Exhibit 210.
18 MR. THOMPSON: Actually, Your Honor, for
19 clarification, I think that exhibit was withdrawn,
20 because Exhibit 202 is a more complete copy of the --
21 JUDGE MOSS: 202 is a response to Staff Data
22 Request 121?
23 MR. THOMPSON: Correct.
24 JUDGE MOSS: And that's the full response, so
25 it's included in 202. But that's what you're talking

00711

1 about is the response?

2 THE WITNESS: Yes, it is.

3 JUDGE MOSS: All right, go ahead with your
4 testimony.

5 A. I would be referring to page six of the
6 document, and I'm not sure what page number that
7 actually is on. I believe there was exhibit page
8 numbers on the top, but I'm referring to page six of the
9 agreement.

10 JUDGE MOSS: That would be page six of the
11 narrative, which appears to bear the page number 13 as
12 far as the exhibit is concerned, if I have it right. It
13 begins in the upper at the very beginning, Commission
14 thereunder as in effect, is that what's at the top of
15 that page that you're looking at?

16 THE WITNESS: Yes.

17 JUDGE MOSS: Okay, then we're all on the same
18 page.

19 A. At the bottom of this page, it describes the
20 criteria for what's included in the consolidated cash
21 flow, and there was a lot of discussion yesterday by the
22 company that their preferred accounting method by
23 amortizing of deferral is a direct item in this
24 calculation under item E. Under Staff's proposal, I
25 believe it would show -- the cash would show up under --

00712

1 directly under item F, which would be a non-cash item,
2 reducing the consolidated net income. And how that
3 would -- how that would come about is that the revenues
4 collected under the tariff based on the FASB or FERC
5 uniform system of accounts for account 254 of the
6 regulatory liability is that the revenues generated
7 under the tariff would be booked as revenues, and that
8 there would be an alternative, or not an alternative,
9 but a non-cash entry to account 407.4, which is a
10 reduction to net income, a debit to that account and a
11 credit to the deferral account, deferred revenue
12 account. So therefore, it would qualify under this if
13 it did not qualify under item G as cash on the balance
14 sheet or as a reduction to the line of credit.

15 MR. FFITCH: All right, thank you. No
16 further questions.

17 JUDGE MOSS: Does the Bench have any
18 questions for Mr. Parvinen?

19

20 E X A M I N A T I O N

21 BY CHAIRWOMAN SHOWALTER:

22 Q. I guess the one question I have is, in your
23 recommendation for a per kilowatt charge as opposed to a
24 percentage surcharge, I understand the rationale laid
25 out in your testimony, but then there have been

00713

1 questions raised about rate shock, and any time we're
2 talking about an increase of the kind of magnitudes that
3 are being floated here, we're in the rate shock
4 category. Your proposal creates a greater rate shock in
5 percentage terms for some customers versus others. Do
6 you agree with that proposition?

7 A. Yes, it does. As a percentage of their -- as
8 a percentage of their bills, it's a larger increase to
9 the Schedule 25 customers, about a 48% increase on the
10 upper, that's on the upper end. And then the Schedule
11 11 would receive only, only, a 22 1/2% increase.

12 Q. And your rationale is, well, that's to be
13 expected, because those people use more power relative
14 to their distribution or transmission costs?

15 A. Exactly.

16 Q. But how do you square it with a kind of an
17 overarching impulse maybe to mitigate rate shock?

18 A. I actually kind of looked at it in terms of
19 all the gas PGA filings we had over the last couple of
20 years and the magnitudes of those. The increases to the
21 large industrial customers on a percentage basis were a
22 lot higher than those of the residential and small
23 commercial, some of those being in the magnitudes of at
24 least in the high 30% range for industrial customers.

25 Q. There was also the idea floated at one point

00714

1 in someone's testimony here this afternoon of stretching
2 the payment period out over a longer period of time, I
3 think ten years was mentioned or maybe -- what is your
4 view about the wisdom of that relative to the fact that
5 these were expenses in a short period of time? Is it --
6 does it make -- is it the --

7 A. Well --

8 Q. Is it good policy to stretch it over that
9 period of time, a longer period of time?

10 A. Well, it's Staff's proposal that the amount
11 of revenue that's being collected is the amount of
12 revenue that is necessary for the company to operate for
13 the rest of the year, so it doesn't seem to me that it
14 would do any good to try to stretch that over time.

15 Q. Well, perhaps I'm thinking of other
16 proposals, Mr. Schoenbeck's idea or the company's
17 itself. But one of the things we need to think about is
18 if we order any kind of relief at all, over what period
19 of time would we authorize it, 90 days, 24 months, 15
20 months, 27 months, 5 years.

21 A. Yes.

22 Q. I guess what are the problems, if any, posed
23 by authorizing some kind of legitimate expense. Let's
24 assume we are comfortable with its recoverability to
25 begin with, but we stretch it out over let's say five

00715

1 years. Something in that seems inappropriate to me, and
2 I'm not sure why. I think it's because there's no asset
3 there, there's no -- it's a prior -- it would have been
4 a prior expense that we're stretching out over a long
5 period of time, and I'm not really sure why I -- it
6 seems incongruous. Do you have any comments on that?

7 A. Well, I think like the company's original
8 proposal back in the June of 1990 where they had
9 proposed amortizing the original estimate of \$20 Million
10 over ten years, that seems similar to the idea that
11 you're trying to get at. Is that --

12 Q. Maybe that's where it came from.

13 A. -- after Phase II and the prudence
14 determination of what is a level of deferred expenses to
15 be recovered, then the Commission and all the parties
16 can come up with their conclusions on what is an
17 appropriate length of time to collect those costs,
18 whether it be over 15 months, 20, 27 months, or some
19 longer period of time to mitigate the rate shock.

20 Q. So once we settle on some amount, you're not
21 particularly perturbed if it were over a longer period
22 of time, you're more concerned about what we do to begin
23 with?

24 A. Right, and especially if things -- if
25 everything calmed down to where there was a normal

00716

1 situation and these aren't ongoing costs, then it would
2 be reasonable, kind of an extraordinary item, then the
3 period of time could be stretched out.

4 CHAIRWOMAN SHOWALTER: Thank you.

5

6

E X A M I N A T I O N

7 BY JUDGE MOSS:

8 Q. Earlier, Mr. Parvinen, I put the question to
9 Mr. Elgin whether there were certain aspects,
10 components, or features of the Staff proposal that were
11 perhaps not as central as others, and he suggested the
12 ending of the deferral as an example of something that
13 was perhaps not critical to the overall structure. And
14 I want to put the same question to you with respect to
15 the proposal.

16 Given Mr. Elgin's description of the Staff's
17 proposal, and I think Mr. Schooley probably underscored
18 this as well as sort of a stopgap measure to get us to
19 the point where we can have the prudence review and the
20 other determinations with respect to these costs, is the
21 cents per kilowatt hour versus uniform percentage matter
22 something that is central to Staff's proposal or
23 something that is less important given the nature of
24 Staff's overall proposal, if you have an opinion on
25 that?

00717

1 A. Well, I use the foundation of past decisions
2 on interim relief cases to base the increases. There's
3 also been like the ECACs, that's my understanding, were
4 also all done on a uniform cents per kwh. The
5 magnitudes of the past interim cases were not of this
6 magnitude, however, so I guess that could be a
7 consideration. For there -- and -- but then you go back
8 to my testimony where there were other reasons including
9 the trackability. For example, if we get to the end and
10 we come up with these prudent level of dollars to be
11 recovered, there's also a decision at that point to be
12 made, okay, how should those costs then be allocated and
13 recovered by the other classes, by all of the classes.
14 That makes it much easier at that point to be able to
15 track, well, who paid in the dollars at this point up to
16 that point.

17 Q. The uniform, I'm sorry, the cents per
18 kilowatt hour?

19 A. Makes it much easier that way.

20 Q. So there's some administrative ease involved
21 in adopting that approach as opposed to the uniform
22 percentage basis?

23 A. Yes.

24 Q. Given the nature of Staff's proposal as being
25 I have called it a stopgap, and I think that's a

00718

1 generally understood term, whether it was actually used
2 by one of the earlier witnesses or not, but given that
3 nature of the Staff proposal, I believe your testimony,
4 I believe it's in your testimony that the cents per
5 kilowatt, uniform cents per kilowatt is something that
6 follows cost causation?

7 A. Yes, it does, in that the emergency rate
8 relief that the Staff is proposing has, you know, been
9 suggested to tie to power costs. Power costs in the
10 last rate case, the primary allocator was energy or
11 volumes, throughput. So from a cost causation
12 standpoint, each kilowatt the company had to go buy for
13 customers would be at a rate -- it wouldn't matter if
14 that kilowatt was for which schedule.

15 JUDGE MOSS: Okay.

16 Any redirect?

17 MR. MEYER: I do have.

18 JUDGE MOSS: Oh, you have some questions?

19 MR. MEYER: I do have some.

20 JUDGE MOSS: Not your witness, so it's not

21 redirect.

22 MR. MEYER: I understand.

23 JUDGE MOSS: All right, go ahead.

24

25

00719

1 C R O S S - E X A M I N A T I O N

2 BY MR. MEYER:

3 Q. Limited recross based on Mr. ffitch's
4 examination. The question or the subject had to do with
5 the company's ability to meet its covenants under a
6 certain bank line. Turn to that same page six that you
7 were directed to.

8 CHAIRWOMAN SHOWALTER: Of what exhibit?

9 MR. MEYER: I think it's the --

10 THE WITNESS: 202.

11 MR. MEYER: Thank you.

12 BY MR. MEYER:

13 Q. And you were directed to the -- I will wait a
14 minute here, although I'm not entirely sure you need to
15 spend much time digesting the language here for purposes
16 of this cross.

17 Were you here yesterday when Mr. Peterson
18 provided his interpretation of this language?

19 A. Yes.

20 Q. Okay. Is it fair to say that Mr. Peterson's
21 interpretation of this definition of consolidated cash
22 flow and its various sub parts differs from your own
23 interpretation?

24 A. No, I remember specifically the question
25 being asked on whether non-cash items reducing the

00720

1 consolidated net income were exactly that, items on the
2 income statement that were non-cash in nature.

3 Q. Well, let's approach this a different way.
4 Did you understand Mr. Peterson to testify yesterday
5 that if the company is unable to use surcharge revenues
6 in order to offset deferral balances that it may have
7 trouble satisfying this covenant?

8 A. Yes.

9 Q. Okay. Did Mr. -- strike that.
10 Were you involved, Mr. Parvinen, in any way
11 in the negotiation of this credit facility?

12 A. No.

13 Q. Would it -- is it your understanding that
14 Mr. Peterson was?

15 A. Yes.

16 Q. Have you, Mr. Parvinen, been in any
17 discussions with banks recently concerning whether your
18 proposed accounting treatment would or would not satisfy
19 this covenant?

20 A. No, I have not.

21 Q. Okay. Suppose you are wrong in your
22 interpretation of this language and the impact of your
23 proposed accounting treatment on satisfying this
24 covenant. Might that prevent -- and yet the Commission
25 were to adopt what you recommend. Might that in and of

00721

1 itself prevent the company from satisfying this
2 covenant?

3 A. Well, I don't believe it does, because of,
4 like I had said, the cash that gets received from here
5 in my perception is that it would hit the consolidated
6 cash flow calculation in a number of different ways.
7 And under cross yesterday, Mr. Peterson had stated that
8 even under the company's proposal, even though it's a
9 direct decrease under item C, there are other places
10 where it could hit the cash income, hit the consolidated
11 cash flow statement. However, you can only count that
12 cash once. Under Staff's proposal, the company is
13 getting the cash.

14 Q. Well, Mr. Parvinen, I'm not asking you to
15 reargue your position versus that of the company's. I'm
16 simply asking you to assume that, in fact, your
17 interpretation of this covenant is wrong and that your
18 proposal, which would not allow the company to offset
19 revenues against deferral balances, would somehow
20 prevent the company from satisfying this covenant. So
21 question, if your interpretation of this covenant is
22 incorrect and if the Commission were to adopt that,
23 might this prevent the company from satisfying the
24 covenant?

25 A. If that were the case, yes.

00722

1 Q. Thank you. And what consequences would flow
2 from the company's inability to satisfy this covenant?
3 Let me be more specific. Would the company be prevented
4 from borrowing under this facility?

5 A. That would be something that would have been
6 more directly asked of Mr. Schooley, I think.

7 MR. MEYER: Thank you, that's all I have.

8 JUDGE MOSS: All right, unless that prompted
9 something further, perhaps redirect.

10 MR. THOMPSON: I have a couple of questions.

11

12 R E D I R E C T E X A M I N A T I O N

13 BY MR. THOMPSON:

14 Q. Mr. Parvinen, how long under Staff's proposal
15 would this be booked in the fashion that Staff proposes?

16 A. It would be booked until the determination of
17 Phase II prudency.

18 Q. And Staff is proposing to resolve the
19 uncertainty surrounding the deferral within fairly short
20 order, correct?

21 A. Yes, Mr. Elgin had stated that Staff could
22 complete the prudency case by the end of the year, in
23 which case -- in which case these dollars at that point,
24 if there was a prudent level of power supply cost
25 determined, then these dollars would be offset against

00723

1 that at that point, which would be the time limit on the
2 next calculation. This calculation, as I understand it,
3 is done quarterly.

4 Q. And so the calculation would be done at the
5 end of December of this year; is that correct?

6 A. I suppose sometime around there.

7 Q. Is it your view that that would resolve the
8 uncertainty that Mr. Meyer was addressing in his
9 questions?

10 A. I believe it would.

11 MR. THOMPSON: Thank you.

12 JUDGE MOSS: All right, Mr. Parvinen, we
13 appreciate you being with us and giving your testimony
14 this evening and release you from the stand.

15 And I believe we had established that we
16 would have Mr. Eliassen back for a little bit of
17 rebuttal.

18 MR. MEYER: Yes, I call to the stand Mr. Jon
19 Eliassen.

20 JUDGE MOSS: We will be off for just a
21 minute.

22 (Discussion off the record.)

23 JUDGE MOSS: Mr. Eliassen, I will simply
24 remind you that you remain under oath for purposes of
25 this proceeding.

00724

1 THE WITNESS: Yes, thank you.

2 JUDGE MOSS: Thank you.

3

4 Whereupon,

5 JON E. ELIASSEN,

6 having been previously duly sworn, was called as a

7 witness herein and was examined and testified as

8 follows:

9

10 DIRECT EXAMINATION

11 BY MR. MEYER:

12 Q. Mr. Eliassen, are you prepared?

13 A. Yes.

14 Q. During several different examinations of
15 several different witnesses appearing over the last day
16 and a half, questions were asked and answered concerning
17 the impact of subsidiaries on the company's current
18 financial situation. To begin with, to what extent were
19 non-regulated businesses a contributor of cash in the
20 recent past?

21 A. All of our non-regulated businesses held
22 under Avista Capital, which houses all of the non-State
23 regulated companies that we own, have been and will be a
24 net contributor of cash to the corporation in the years
25 2000 and 2001. And I think that was inherent in the

00725

1 original filings. I mean that material was included
2 there. So were a net cash contributor to the utility,
3 in effect, since the utility is the corporation. And we
4 have also been a very strong contributor of earnings
5 through the non-regulated businesses, through the
6 consolidated company in 2000 and 2001. The
7 non-regulated businesses earned a 44% return on equity
8 in 2000. They have earned a 36% return on equity
9 through June 30 of this year.

10 Q. So in what sense, if at all, were these
11 non-regulated companies responsible for the company's
12 current financial condition?

13 A. The subsidiaries through Avista Capital,
14 Avista Energy, and all the other companies have not in
15 any way been a detriment to the utility, contrary to
16 some of the comments that I have heard in answers to
17 other questions over the last couple of days. The
18 utility's access to financing is no way -- there has
19 been no detriment to the utility's ability to finance
20 based on any of the utilities -- of the non-regulated
21 companies' operations in the last two years.

22 Q. And why do you say that?

23 A. Well, I think, let's see, I need to refer to
24 I think its my Exhibit 154 if it was actually entered.
25 It was Staff Data Request 122-C. That has --

00726

1 Q. Just wait a minute so the people can refer to
2 that.

3 A. Right.

4 JUDGE MOSS: This is 154-C?

5 A. Right, it was entered as confidential, but
6 the numbers I'm going to refer to are very simply -- I
7 don't know how the pages are numbered. In the -- within
8 that document about six pages back and it says
9 confidential page four at the bottom. It's internal
10 cash generation. The summary that I'm going to give you
11 basically comes from this and then current information
12 that has been testified to in the last day.

13 Investments in subsidiary companies, which is
14 about three quarters of the way down the list. In 1998,
15 we had invested \$41,500,000 in subsidiary companies.

16 CHAIRWOMAN SHOWALTER: Can you hold up a
17 minute?

18 THE WITNESS: Sure.

19 CHAIRWOMAN SHOWALTER: I just want to make
20 sure we are on the same page.

21 THE WITNESS: It would be internal cash
22 generation, and the only page number I have is page four
23 in the lower right-hand corner.

24 JUDGE MOSS: We always ask counsel to be sure
25 that the exhibits have page numbers, and in this case,

00727

1 we have a surfeit of page numbers I think on several
2 exhibits.

3 THE WITNESS: You're right.

4 JUDGE MOSS: So we will bear with you.

5 THE WITNESS: I apologize.

6 A. But also then in 19 --

7 CHAIRWOMAN SHOWALTER: Can you go back to the
8 line you were talking about, because I was on the wrong
9 page.

10 THE WITNESS: Yes.

11 CHAIRWOMAN SHOWALTER: Tell me what line it
12 is.

13 THE WITNESS: Well, unfortunately, if you go
14 down -- it's four lines up from the bottom, it says
15 investment in subsidiaries, we invested 40 --

16 COMMISSIONER HEMSTAD: I'm sorry, now I'm on
17 the wrong page. What page are we on?

18 THE WITNESS: It's page four, internal cash
19 generation, unconsolidated is the heading.

20 CHAIRWOMAN SHOWALTER: There are two page
21 numbering systems.

22 A. I could do this without the reference to the
23 page. I could just give you numbers.

24 But I think what's important is that if you
25 find the line that says investment in subsidiaries, we

00728

1 invested \$41.5 Million in 1998. We invested another \$40
2 Million in the year 1999. And the next line shows notes
3 to Avista Capital. That \$113 Million in the year 2000
4 net of the Coyote Springs investment that was made in
5 that year since we started construction of Coyote in the
6 year 2000, the net is about \$50 Million of loans to
7 Avista Capital for other than Coyote Springs. Those
8 three numbers total \$131 Million.

9 Now what doesn't show on this, and I'm going
10 to update you based on the testimony of Mr. Ely
11 yesterday and the commitments we have made to our
12 commercial banks, plus the plan we have in place to --
13 originally we were going to dividend \$150 Million in Q2
14 from Avista Capital back to Avista Corporation to
15 rebuild the equity of the parent company and rebuild the
16 equity of the utility. Because of what we're doing with
17 banks today and tomorrow and whenever we get this waiver
18 signed, we will actually dividend \$30 Million this year,
19 and we will dividend another \$120 Million next year.
20 But the net of all those numbers is that we will have
21 \$145 Million of cash from the subsidiaries flowing to
22 the utility between Q3 of this year and Q2 of next year.
23 That's a net, not a lot, of only \$14 Million over five
24 years, but subsidiaries are a huge contributor in this
25 current period of 2000, 2001, 2002.

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1 In addition, in the year 2000 and the year
2 2001, Avista Capital or the subsidiaries contributed
3 \$153 Million of earnings. Now the utility itself in a
4 good year only earns \$48 Million or \$50 Million or \$55
5 Million. That's all we earn. We earn \$1, \$1.10 cents a
6 share. So in the last two years or in the two years
7 2000 and 2001, Avista Capital companies will contribute
8 over \$150 Million of earnings to this corporation. I
9 find that an entirely different picture than what has
10 been cast in some of the testimony earlier.

11 BY MR. MEYER:

12 Q. Mr. Eliassen, that contribution that you just
13 spoke to with reference to non-regulated subsidiaries
14 does not in any way mitigate, does it, this company's
15 request or its stated need for surcharge relief?

16 A. It has nothing to do with the surcharge.
17 It's only one way that we're moving capital within the
18 company to rebuild the equity of the utility to make
19 sure that the utility is a strong business going
20 forward, but also to rebuild the company's cash flows in
21 other ways. We can move money to do capital things.
22 This money will be spent on things probably other than
23 Coyote unfortunately, but it has nothing to do with
24 recovery of the surcharge or paying the bills for those
25 \$300 Million plus dollars that we have invested in

00730

1 deferrals for gas and electricity through Q3 of this
2 year. So while we've got all this money coming in and
3 planned to come in from these businesses, it's not
4 nearly enough to tide this company over given the amount
5 that we have invested in gas and electric deferrals.

6 Q. Referencing those deferral balance just as a
7 frame of referral, the deferral balances as of June 30
8 are what?

9 A. As of June 30, well, the Washington electric
10 deferral balances were \$109 Million.

11 Q. And what of the September 30th balance?

12 A. Our estimates are that deferral balances will
13 be \$185 Million at the end of September, and I think
14 that that number needs to be put in context. We know
15 that the balance at the end of August will be \$165
16 Million rounded one way or the other. It's a known
17 number, and the numbers that are coming in in this Q3
18 are based on contracts that are known as well.

19 Q. How much, if any, of those deferrals for
20 August or September reflect in any way Coyote Springs?

21 A. None of the dollars through August reflect --
22 none of the dollars through September of the \$185
23 Million that I'm most concerned about when I speak to
24 bankers in the financial company, none of the \$185
25 Million represents anything for Coyote Springs.

00731

1 Q. With reference to Mr. Schoenbeck's discussion
2 around hydro availability, I believe that Mr. Schoenbeck
3 observed, my paraphrase here, that perhaps there might
4 be recent information relating to an increase in
5 precipitation. Do you have any such recent information
6 regarding hydrogeneration for Avista System?

7 A. I do. It's interesting though that
8 Mr. Schoenbeck even this morning allowed that he thought
9 that our estimates for Q3 might be fairly accurate, and
10 it's interesting to note that our July estimate for
11 average megawatt hours of generation 338, that came in
12 at 318. Average generation, average megawatts for
13 August from the hydro systems estimated at 246, that's
14 inherent in our deferral plan, it actually was 236. So
15 in both of those months, our estimates were slightly
16 high for hydrogeneration.

17 In September, we have estimated 228
18 originally. That's what's in the filing before you.
19 Our current estimate is based on the actuals for August.
20 It will be at 216. So all of this points out is we're
21 probably buying a little bit more energy on the spot
22 market to meet loads on a daily basis or prescheduled
23 basis than we had planned. But again, I think it lends
24 a lot of credibility to the numbers that we have in this
25 case. We will be at \$185 Million in Washington for

00732

1 electric deferrals at the end of September. It is a
2 critical number for us.

3 Q. So, Mr. Eliassen, are the levels of the
4 September 30th deferral balances supported by the
5 company in its testimony?

6 A. Yes, they are.

7 Q. Now --

8 A. One --

9 Q. Go ahead.

10 A. One of the other things that --

11 MR. FFITCH: I'm going to object, Your Honor,
12 this is a beginning of a narrative statement here from
13 the witness without a question from counsel.

14 JUDGE MOSS: Let's do proceed with a Q and A.

15 BY MR. MEYER:

16 Q. All right, turning now to the perceptions of
17 the financial community, Mr. Eliassen, what has the
18 financial community told you about how important our
19 surcharge is in the amount and in the fashion requested
20 by the company?

21 A. I think we have gone over this in some detail
22 before, but just to reiterate, the banks, the commercial
23 banks we deal with say it is critical to have a
24 surcharge, but not so much the surcharge, I don't want
25 to downplay having a surcharge, but we need to have a

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1 plan that offers the opportunity for recovery subject to
2 prudence. That's really what we need. We need to have
3 something that people -- and your -- and the Staff has
4 testified to this, there needs to be a plan. It doesn't
5 have to be necessarily certain in terms of total
6 dollars, but it needs to be certain in terms of the
7 mechanism over the next 12 to 18 months or so. We need
8 to have something that gets us out past the end of this
9 year. That's critical. Investment banks have told us
10 the same thing.

11 If any of the proposals by Staff or others
12 that cast a doubt on whether or not we can have full
13 recovery or would cast a doubt in the sense of having to
14 set up a liability on the books that might otherwise
15 then have to be written off and not really recognized as
16 anything other than expense, those kinds of things are
17 going to preclude us from issuing common equity in the
18 near term. We may not be able to access common equity
19 markets even this fall anyway. But an order that
20 continues to prolong the uncertainty, even if it's a 90
21 day study by the Staff between now and the end of the
22 year, absolutely guarantees we will not be in the equity
23 markets and may not be in the debt markets during this
24 period of time.

25 And more importantly, rating agencies --

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1 MR. FFITCH: Objection, Your Honor, this is
2 turning into an --

3 THE WITNESS: I'm sorry.

4 MR. FFITCH: -- essentially undirected
5 narrative statement from the witness, much of which is
6 repetitious and cumulative of prior testimony of this
7 and other witnesses of the company. I don't think it's
8 proper rebuttal.

9 MR. TROTTER: I will join the objection.

10 JUDGE MOSS: Well, the witness's propensity
11 toward long answers is not in and of itself
12 objectionable, so long as they are responsive to the
13 questions, but I will ask you, Mr. Eliassen, to be
14 listening carefully to the questions and answering only
15 the questions asked even though you may have much more
16 to say on the subject.

17 THE WITNESS: Yes.

18 JUDGE MOSS: Go ahead with your next
19 question.

20 BY MR. MEYER:

21 Q. Mr. Eliassen, do you believe that
22 Mr. Schoenbeck's proposals or those of Staff then
23 satisfy the requirements of a good plan acceptable in
24 the eyes of the banking community?

25 A. I do not believe that Staff's are a good

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1 plan. I do think that Mr. Schoenbeck's proposals move
2 toward what a plan needs to be. I think that there are
3 some keys in Mr. Schoenbeck's that recognize the need
4 for a plan. He recognizes that prudence can be
5 determined simultaneously with the recovery of a
6 surcharge, which is important to us. He retains the
7 deferral mechanism. That's critical to the company,
8 otherwise we will have huge writeoffs. He uses
9 appropriately, I believe, the Portland General Electric
10 contract, which was based on a power plant, and he uses
11 power plant related benefits for the customer to offset
12 power costs. I think that's appropriate.

13 I don't think it goes far enough. I don't
14 think it recognizes the company's immediate need for
15 cash from the surcharge as well, because I think
16 Mr. Schoenbeck's plan is roughly a \$30 Million annual
17 plan. I think that the company's proposal, given the
18 fact that we will have the \$185 Million accumulated for
19 Washington by the end of September, collecting \$87
20 Million over the next 12 months while we have a general
21 filing, run a prudency review, and address Coyote and
22 all the other assets the company is putting on line, I
23 think that's a much better way to go and really does
24 address or help us address the needs we have in the
25 financial community.

00736

1 Q. I believe, Mr. Eliassen, that Mr. Elgin was
2 asked to compare the company's financial situation in
3 the early '80's and its need for rate relief then with
4 -- compare it with where the company finds itself now.
5 Would you please comment?

6 A. Yes, just briefly on that, the company's
7 total equity in the mid '80's, I think this is probably
8 prior to the writeoff of WNP-III, was in the range of
9 \$480 Million. Now if you looked at our total equity
10 today associated with the utility business, electric and
11 gas, we have less than \$400 Million of equity allocated
12 to the utility business today. In fact, if we had a
13 writeoff of \$185 Million, we would have less than \$200
14 Million of equity left in the regulated business
15 supporting our entire utility business for Washington
16 and Idaho. We are not nearly as strong in terms of an
17 equity position as we were then. The size of the
18 company, not much greater today. Net assets, net
19 utility assets today are only \$400 Million or \$500
20 Million greater.

21 Q. You heard Mr. Schoenbeck's comments about the
22 surcharge as proposed and whether it would drive
23 companies out of business in the Avista service
24 territory. Do you have any comments?

25 A. Yes, I did hear those comments that he made.

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1 When we filed this case, and I'm not sure what the
2 Commission may have gotten in the way of letters, but we
3 have had very strong support from the business community
4 in Spokane and Spokane area, we have had very strong
5 support in editorials in the local paper. We have had
6 very strong support from the Chamber of Commerce and
7 from the EDC, the Economic Development Counsel. And I
8 think this is a recognition that in the state of
9 Washington, in the Northwest, there have been rate
10 increases that have been 30%, 40%, 50% or more. We're
11 not faced with anything different than Seattle City
12 Light or Tacoma or any of the other agencies of the
13 Northwest or the West Coast have been faced with. And
14 we have to deal with it in the same way. They have
15 increased rates, and I don't know if there have been any
16 bankruptcies because of it.

17 Q. Lastly, Mr. Eliassen, Mr. Parvinen addressed
18 the subject again of amortization of the deferrals and
19 whether the revenues should or should not be used to
20 offset deferral balances. Mr. Eliassen, why is the
21 amortization of deferrals with the corresponding cash
22 recovery through the surcharge critical to the company?

23 A. Well, cash is critical to the company to
24 start with from any source. But the amortization is
25 critical to us in terms of how we have to meet the

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1 covenants. It's our understanding from the banks that
2 we negotiated this line with that we can't just have an
3 offset to the deferral account and count it toward
4 meeting the covenants. The amortization of the deferral
5 balance is critical to show a path. And again, we're
6 going on a path here of amortizing \$185 Million, which
7 will only be down to 180, or not 180, excuse me, down to
8 80 or 90 or 100 in 12 months. It's not going to be
9 eliminated overnight, but at least we would have a plan.

10 The concern I have is we need to do this
11 right, we need to have a plan that puts in place not
12 only addressing the deferrals and recovery of those, but
13 rate basing Coyote Springs if we buy it, rate basing
14 other plant if we can afford it. We have to have some
15 of these things in place by March or April of next year,
16 because that's when we start renegotiating this same
17 line of credit. I don't want first mortgage bonds
18 supporting my lines of credit in the future, so we've
19 got to get the company back on its feet fairly fast to
20 even obtain a line of credit.

21 So we've got a time frame here that's not the
22 end of the year, but certainly it's March or April of
23 next year. To get from here to there, we need a plan
24 that addresses cash, we need a plan that addresses
25 deferral amortization, and we need a plan that allows us

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1 to work with you and the Staff on prudence of all the
2 expenses that have gone into that account. But we do
3 need to address the deferrals. It's not just a cash
4 deal.

5 MR. MEYER: That completes my sur rebuttal.

6 JUDGE MOSS: Mr. Trotter, did you have
7 some --

8 MR. TROTTER: I will go last if I can.

9 JUDGE MOSS: All right, permission granted.
10 Mr. Van Cleve.

11

12 C R O S S - E X A M I N A T I O N

13 BY MR. VAN CLEVE:

14 Q. Mr. Eliassen, did you begin your testimony
15 here tonight by stating that the company's unregulated
16 subsidiaries have not in any way been a detriment to the
17 utility or its ability to attract capital?

18 A. In the last two years. I was -- that's
19 couched in terms of 2000 and 2001, and I think that's
20 supported, by the way, by the fact that the company was
21 A rated with negative comments from the rating agencies
22 prior to the problems that the utility has had starting
23 in Q2 of last year. And all the downgrades and all the
24 negative comments that have come from the rating
25 agencies very specifically reference issues with the

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1 utility, with the growing deferral balances, with cash
2 flow. And they say, yes, we still have non-regulated
3 subs that they are concerned about, but we have been
4 addressing those issues with them. Those aren't what's
5 driving changes in ratings or negative outlook in the
6 last 18 months.

7 Q. And what was, prior to that 18 months, what
8 was driving changes in ratings and negative outlooks?

9 A. Negative outlook prior to that was because we
10 lost plenty of energy marketing and trade through Avista
11 Energy in 1999.

12 Q. So you would agree, wouldn't you, that the
13 company would be in a lot better financial position to
14 deal with this liquidity crisis if it had not had power
15 trading losses and rating downgrades as a result of
16 non-regulated activities?

17 A. I would not. In fact, I think if you looked
18 at Avista Energy by itself over the last four years, it
19 has made as much money as the utility has, perhaps more
20 during that four year period. So the utility had a big
21 loss share as well, energy I think one year as well.
22 But I would not agree with your statement. I have met
23 with rating agencies every 30 to 45 days for the last
24 year and a half.

25 Q. When did the company have an A credit rating?

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1 A. Well, it's in -- I think there's an exhibit
2 in Mr. Peterson's testimony that shows the dates, but I
3 can't tell you the exact dates off the top of my head,
4 or if there's another reference in the Staff request,
5 may be a better --
6 MR. MEYER: May I approach the witness?
7 JUDGE MOSS: Yes.
8 THE WITNESS: Yeah, I don't have the -- I
9 don't have the dates of the change within the years, but
10 in Mr. Peterson's Exhibit, page four shows the Fitch,
11 Moody's, Standard & Poor's rating of the company.
12 CHAIRWOMAN SHOWALTER: What exhibit number?
13 MR. MEYER: 201.
14 A. And to answer your question, the last time --
15 MR. MEYER: Page four.
16 A. We had an A-3 rating at Moody's through the
17 end of 1999 for secured debt. We had an A rating at
18 Standard & Poor's for secured debt through 1998.
19 BY MR. VAN CLEVE:
20 Q. Mr. Eliassen, do you have Exhibit 651, which
21 is Mr. Thornton's testimony?
22 MR. MEYER: I can provide one to him.
23 MR. VAN CLEVE: Thank you.
24 A. Yes, the answer is no, I don't.
25 I have it.

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1 BY MR. VAN CLEVE:

2 Q. Could you please refer to page 5, line 13, of
3 Exhibit 651.

4 A. And this is on August 13, 1999?

5 Q. Correct. There was a ratings downgrade by
6 Duff & Phelps, and there's a quote from the press
7 release which states:

8 The downgrade is based on increasing
9 business risk through investments in
10 unregulated subsidiaries.

11 A. That's correct.

12 Q. Would you agree that that was the principal
13 reason for that downgrade?

14 A. Yes, my statement was that ever since 2000,
15 the principal rating changes in 2000 and 2001 have all
16 been because of the utility, and it's 2000 and 2001
17 where we have incurred the deferrals and incurred all of
18 the rest of the charges that have brought us here today.
19 I don't disagree with what he pointed out about 1999,
20 but that wasn't my point.

21 Q. Okay, could you refer to page seven of
22 Exhibit 651.

23 JUDGE MOSS: I think we're looking at Exhibit
24 601, aren't we?

25 MR. VAN CLEVE: I'm sorry, Your Honor, 601?

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1 JUDGE MOSS: Thornton testimony?

2 MR. VAN CLEVE: Yes.

3 JUDGE MOSS: Yes.

4 MR. VAN CLEVE: Sorry about that.

5 BY MR. VAN CLEVE:

6 Q. And on page seven at line two, it refers to
7 an S&P revision of its outlook from stable to negative.
8 Do you see that?

9 A. Yes.

10 Q. And there's a quote from the S&P press
11 release, and it said that:

12 The outlook revision reflects a
13 weakening of Avista's financial position
14 primarily as a result of poor
15 performance of the company's
16 non-regulated trading operations.

17 Would you agree that that's what S&P said?

18 A. Yes, they did, and it's still coming off the
19 1999 writeoffs and the issues around the national
20 trading operations in that year.

21 Q. But that is an impact in 2000 on the credit
22 position of the company, correct?

23 A. It was in the direction, but it was not a
24 change in rating, because when you say the change in
25 rating when S&P downgraded this, it speaks directly

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1 about utility issues and says that they're still
2 concerned about our non-regulated businesses. They have
3 never said that they weren't concerned about them.

4 Q. And if you refer to page 8 at line 12,
5 there's a reference to Fitch downgrading the company's
6 securities on June 23rd, 2000, and there's a quote from
7 the Fitch press release, and it refers to the \$98
8 Million in unregulated trading losses, doesn't it?

9 A. It does, but again, I don't have the full
10 text of this one. I'm not familiar with what the text
11 of this said.

12 Q. And on line 26, the quote from the release
13 says that:

14 Avista Corporation has been infusing
15 funds into its unregulated subsidiaries.
16 While these moneys are booked as loans,
17 they are significant amounts that
18 decrease Avista Corp's financial
19 flexibility.

20 A. And as I just testified, we're putting \$150
21 Million of that cash back into the utility this year and
22 next year, more than paying back all of those
23 investments. It's 2000 and 2001 we're dealing with here
24 today and 2002 as a company.

25 Q. And if you look at line 32 on page 8 of

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1 Exhibit 601, it talks about a Moody's downgrade on July
2 27, 2000. If you look -- turn the page to page 9 and
3 look at lines 9 through 11, it states that:

4 Moody's remains concerned about the
5 extent to which Avista expects to rely
6 on earnings from its more risky
7 non-regulated businesses going forward.

8 A. Right, I think if you look at the entire text
9 of most of these though, you see that their concerns
10 were about deferral balances, issues in energy markets,
11 the same thing that brought us here today, the same
12 thing addressed to this Commission a year ago.

13 And again, the rating agencies have always
14 had a concern even back prior to 1998 about
15 non-regulated businesses, but they are not the key
16 today. They have not been the key in our ratings for
17 the last 12 months, and that's the point here today.
18 The utility, lack of liquidity and the deferral balances
19 with no plan, no plan and no opportunity to recover
20 prudently incurred costs is the biggest issue we face.

21 Q. Well, when is it that the primary concern of
22 the rating agencies switched from the unregulated
23 operations to the regulated?

24 A. Well, in what was Staff Request 108, and I'm
25 not sure now what -- I lost my reference to it. I'm not

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1 sure what exhibit it is, but Staff Request 1, Data
2 Request 108, which included the current -- the complete
3 statements from Moody's and S&P this year, for example,
4 Moody's comments in July or August, anticipated buildup
5 in energy deferral costs of Avista which reached \$140
6 Million, the buildup in deferrals due to a confluence of
7 circumstances including the worst draught conditions,
8 pricing for wholesale power, I'm paraphrasing, changing
9 market conditions, fixed income investors should remain
10 wary absent significant levels of support from
11 regulators to implement rate surcharge. And this is
12 cash flow is subject to pretty extreme pressure.

13 But again, you go down through the first two
14 paragraphs of this, it talks about the importance of the
15 impact on the company of regulated activities, the
16 importance of having regulation as a part of the
17 solution, and then it gets down and says, we're still
18 dealing with regulated companies, with the unregulated
19 companies, we still have concerns about the investment
20 in non-regulated business, but it's not the driver, and
21 the same is true with the S&P.

22 Q. Excuse me, before you go on, can you tell me
23 what the date of the document is that you were referring
24 to?

25 A. This one is July 26, 2001.

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1 Q. Okay. And was that a downgrade then?

2 A. No, this was where we continue to be placed
3 on -- Moody's investor service is maintaining the
4 negative outlook for Avista Corporation's ratings.

5 Q. And what was the Moody's rating at the time?

6 A. It's still B double A for senior security.

7 Q. Okay. So as I understand your testimony, the
8 company was an A-3 before it started incurring trading
9 losses and risky investments in unregulated
10 subsidiaries. So this credit rating of the company had
11 been substantially reduced by the time that the utility
12 issues became a concern; is that correct?

13 A. It had been reduced from the A level to
14 triple B double A or triple B level, yes.

15 Q. How many rating taggers is that?

16 A. From A-3 to B double A-1 is one step.

17 Q. Okay. And what were the S&P rating
18 categories at the same -- at that -- well, let's start
19 out what was the S&P rating category in 1998?

20 A. Well, again, for 1998 it was A. In 1999 it
21 fell to triple B plus. It was still triple B plus for
22 secured debt at the end of 2000 according to
23 Mr. Peterson's exhibit. During 2001, the outlook was
24 reduced to negative, and then the downgrade occurred at
25 S&P in August of this year. Again, my point is that the

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1 concerns since 2000 and 2001 have been entirely around
2 -- the growing concerns have been entirely around the
3 deferral balances and the utility operations.

4 Q. And I guess my question is, the company
5 through numerous rating agency reports was either
6 downgraded or given a negative outlook because of the
7 poor performance of its non-regulated trading
8 operations, and if it had not engaged in those
9 non-regulated operations, wouldn't it have been in a
10 better financial position to withstand this crisis that
11 it's facing now?

12 A. We would not, in my estimation. That had
13 nothing to do with the deferral balances. It has
14 nothing to do with covering the \$300 Million we have
15 invested in deferred energy cost. The non-regulated
16 businesses have earned a lot of money in the last two
17 years. We have at the same time listened to the rating
18 agencies, as Mr. Ely testified yesterday, we're taking
19 steps with certain ones of them and even the ones that
20 would remain, even the marketing operation is
21 substantially reduced in size today from where it was
22 even a year ago. We have listened to those concerns,
23 those companies are being downsized.

24 But at the same time, we're taking cash and
25 earnings from them to support the corporation. They

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1 can't --

2 JUDGE MOSS: Mr. Eliassen, I think there's no
3 question pending.

4 Q. You testified regarding the potential impact
5 of Mr. Schoenbeck's proposal. Have you asked any of
6 your bankers what their reaction to Mr. Schoenbeck's
7 proposal is?

8 A. I have not. The --

9 MR. VAN CLEVE: Thank you, that's all I need.
10 That's all I have, Your Honor.

11 JUDGE MOSS: All right, then we have Public
12 Counsel next, Mr. ffitch.

13 MR. FFITCH: Thank you, Your Honor.

14

15 C R O S S - E X A M I N A T I O N

16 BY MR. FFITCH:

17 Q. Good evening, Mr. Eliassen.

18 So just to make sure I understand your
19 testimony just in very recent exchange, essentially your
20 testimony is that the non-regulated activities of Avista
21 and the resulting downgrades in the investment ratings
22 have nothing to do with Avista's current financial
23 difficulties at all; is that your testimony?

24 A. Tied to 2000 and 2001, I would suggest that
25 any -- everything that's happened since Q2 of last year

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1 has been primarily utility oriented. What we have tried
2 to do since then is strengthen the non-regulated
3 businesses at the same time we have been trying to deal
4 with issues at the utility.

5 Q. Is it your testimony that the non-regulated
6 activities of Avista have nothing whatever to do with
7 Avista Corp's current financial difficulties?

8 JUDGE MOSS: He's looking for a yes or no
9 answer, Mr. Eliassen. If you can give it to him, do.

10 A. I would say not, no.

11 Q. That's not your testimony?

12 A. I'm sorry, maybe I misunderstood.

13 Q. Your testimony is that they have -- these
14 activities have nothing whatever to do with Avista's
15 current financial situation?

16 A. I would say that's correct today, yes.

17 Q. And it's, as I understand it, again your
18 testimony is that the infusion of cash from the
19 subsidiaries at this point has nothing whatever to do
20 with solving the problem which is brought to the
21 Commission here which requires a surcharge; is that also
22 correct?

23 A. Moving cash from the subsidiaries and even
24 strengthening them still doesn't recover the deferral
25 balance. So it helps the cash problem, but it doesn't

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1 help the deferral problem.

2 Q. Do the subsidiaries have an ability to infuse
3 additional amounts of cash into the utility or the
4 corporation than they are currently doing?

5 A. Not and continue to operate, no.

6 Q. And will that cash infusion from the
7 subsidiaries have any impact in the future on the
8 company's investment grade, or would you expect it to
9 have?

10 A. I would expect it would, yes.

11 Q. That would improve the company's financial
12 situation?

13 A. I would hope so, yes.

14 Q. And give the company the ability to seek
15 financing without having to go to its rate payers or
16 obtain financing, excuse me?

17 A. The only thing we're asking from the rate
18 payers is to help recover costs that have been incurred
19 for power costs.

20 Q. And on that point, you indicated that Avista
21 is doing nothing more than dealing with this situation
22 the same way as other utilities of the state, and I
23 think you mentioned Seattle City Light, for example; was
24 that your testimony?

25 A. Maybe I misspoke on that. I said I think

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1 we're facing the same issue that most other utilities
2 have faced, many of which have had to raise rates such
3 as Seattle City Light, Tacoma, and others.

4 Q. You don't recall saying that you're dealing
5 with it in the same way as those utilities?

6 A. Well, we're dealing with it in the same way
7 in the sense that we're asking for an increase from our
8 customers to cover the cost of providing the services,
9 yes.

10 Q. Now you indicated that Avista Energy is --
11 excuse me, that many of the subsidiaries have made a lot
12 of money in the last two years; does that include Avista
13 Energy?

14 A. Yes.

15 Q. And is that because Avista Energy has been
16 selling energy in the wholesale markets in the West?

17 A. We have been marketing both energy and/or
18 electricity and natural gas, yes.

19 Q. And in the electricity market, can you tell
20 me what the earnings of Avista Energy have been in the
21 last two years, the period that you mentioned when a lot
22 of money has been made?

23 A. Well, I think that the -- I think in the same
24 document that we referred to, 122-C, Exhibit 154, I'm
25 sorry, the Avista Energy earnings show in that

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1 information.

2 Q. If you could give me a minute, I can locate
3 that.

4 A. Do you want me to just give you the numbers?

5 Q. I think --

6 A. The income statement, page one, has Avista
7 Energy as a separate line item.

8 JUDGE MOSS: This is a confidential exhibit,
9 so we wouldn't want to state the numbers on the record,
10 but if you can just point us to the place where they're
11 located in the exhibit, we can all look at it.

12 A. Well, I'm okay with this on the record though
13 since we actually publish these numbers at this level,
14 the earnings numbers we do publish.

15 JUDGE MOSS: All right, well, it's your
16 confidentiality claim, so as long as your counsel
17 doesn't throw a gag around you, go ahead.

18 A. Well, the number for 2000 is \$165 Million,
19 and the estimate for 2001 is \$57 Million from Avista
20 Energy.

21 CHAIRWOMAN SHOWALTER: Can you tell me where
22 to find that?

23 A. That's in that document, it's labeled page --
24 it's actually the third or the second page. It's a page
25 of assumptions, and then the first page that's numbered

00754

1 is page one, income statement, and two thirds of the way
2 down or about halfway down the page, there is a heading
3 other income, and Avista Energy is shown there.

4 BY MR. FFITCH:

5 Q. And Avista Energy is a net seller in the
6 western wholesale markets of electricity; isn't that
7 correct?

8 A. Well, they -- I'm not quite sure how to
9 answer that, yes.

10 Q. Now you indicated again that Avista is
11 dealing with this energy situation in the same way as
12 other utilities in the West. You're aware, are you not,
13 that other utilities, and you mentioned specifically
14 Seattle, are actually seeking refunds before the Federal
15 Energy Regulatory Commission for excessive energy
16 expenditures; aren't you aware of that?

17 A. Yes, I am.

18 Q. Avista Corporation is not engaged in that
19 similar request, is it?

20 A. Mr. Norwood testified to that yesterday, that
21 we have been monitoring and are part of certain parts of
22 the proceedings.

23 Q. That's right, and you're not currently
24 supporting refunds for Avista Corporation in that
25 proceeding, are you?

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1 A. No.

2 Q. And Avista Corporation, the utility, is,
3 however, a net purchaser of energy in that market, is it
4 not?

5 A. We have been both a purchaser and a seller,
6 and I think Mr. Norwood testified yesterday that he was
7 uncertain which way it might go. But we have retained a
8 spot at the table, if you will, so that we can
9 participate if and when it's appropriate.

10 Q. Well, the hearings drew to a close today
11 without Avista Corporation making any claim for refunds;
12 isn't that true?

13 A. I don't think we have given up a right for a
14 claim.

15 Q. The transcript will speak for itself, I
16 believe I recall Mr. Norwood indicating that --

17 JUDGE MOSS: Let's move along, Mr. Ffitch, we
18 covered this yesterday.

19 Q. -- Avista Corp was a net purchaser.

20 MR. FFITCH: Those are all the questions I
21 have. Thank you, Mr. Eliassen.

22 JUDGE MOSS: Thank you, Mr. ffitch.

23 MR. TROTTER: Just one, Your Honor.

24

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00756

1 C R O S S - E X A M I N A T I O N

2 BY MR. TROTTER:

3 Q. You indicated that the cash infusion of \$150
4 Million through the end of this year and next year helps
5 the cash problem. Do you recall saying that?

6 A. Yes, I do.

7 Q. And has that cash infusion been reflected on
8 Mr. Peterson's exhibit where he estimates the fixed
9 charge coverage ratio?

10 A. In the initial filing, I'm quite sure it was.
11 I don't have that sheet in front of me either. There
12 was the initial filing list has a 2001, 2002 estimates
13 of meeting covenant test, and it is in there, it should
14 be in there in Q2. I don't have a reference or page
15 number. But what we planned --

16 Q. My question was whether it's on the exhibit,
17 that's all.

18 A. Okay, it should be in Q2, yes.

19 MR. TROTTER: That's all I have, thank you.

20 JUDGE MOSS: Any questions from the Bench?

21 All right, we would like to issue a Bench
22 Request, we will reserve Exhibit Number 6, and what we
23 would like to have I suppose the company can most
24 conveniently provide us the full text of the various
25 Moody's, Standard & Poor's, Fitch, and if I'm missing

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1 any of the other rating agency reports that Mr. Eliassen
2 has indicated, we might benefit from reading more fully.

3 CHAIRWOMAN SHOWALTER: I want to make sure
4 that it includes the text of -- the full text of what
5 has been included in Exhibit --

6 JUDGE MOSS: Mr. Thornton's testimony,
7 Exhibit 601.

8 CHAIRWOMAN SHOWALTER: Right. And it should
9 probably go back at least as far as 1998. I don't know
10 how many documents I'm asking for. It would be both the
11 downgrading sorts as well as the outlook sorts.

12 MR. MEYER: Okay, we can do that.

13 MR. TROTTER: Your Honor, I believe some of
14 these are contained in Exhibit 604 already.

15 THE WITNESS: I believe they are.

16 MR. TROTTER: So perhaps the company can
17 confirm that it's the complete set.

18 MR. MEYER: We will do that. We will confirm
19 whether it goes back and captures all of those to 1998.

20 JUDGE MOSS: All right. Thank you, and we
21 will get it satisfied in one way or the other.

22 And thank you for pointing that out,
23 Mr. Trotter.

24 All right.

25

E X A M I N A T I O N

1

2 BY CHAIRWOMAN SHOWALTER:

3

4 Q. I do have a question, and that is how
5 important to the company the tail end of its proposal
6 is. And by tail end, I mean the 27 months as opposed to
7 some lesser number of months. If you take the company's
8 proposal and assume just for example that you will have
9 \$185 Million in the deferred deferral account through
10 this September, I think you said your proposal would
11 collect \$87 Million in the next 12 months. If this
12 Commission ordered a surcharge at approximately the rate
13 that you have requested, but the surcharge were to
14 terminate say at the end of 2002, in other words go for
15 15 months as opposed to 27 months, by which time this
16 Commission would have had other proceedings that address
17 a general rate case as well as recoverability of the
18 deferral account and continue the deferral account
19 during that time, something like Mr. Schoenbeck is
20 proposing, although not necessarily at the amounts that
21 he has come in on, my question is, how important to the
22 company or to its financiers is an order from this
23 Commission addressing the full amount through 27 months
24 versus some amount through a shorter period?

24

25

A. If we had a plan as you have outlined that
gave us that level of annual revenues, that level of

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1 annual cash, and it includes the PGE offset as well,
2 because I think that's appropriate to drive the
3 deferrals down as quickly as possible, with that, we
4 will file in November a general filing that gives you
5 the opportunity to do everything you need to do parallel
6 on prudence. I mean a lot of the contracts are still
7 going to be in place during that period of time, fuel
8 costs, new plant, all the things that the Staff does
9 need to and should be looking at, all that can be
10 included. And I think that that period of time then
11 would allow us to have even the full 11 months for that
12 case to be decided. We would still have an order by
13 October. And I think a plan that addresses the next 15
14 months or 16 months, whatever it might be, on those
15 terms would be very acceptable.

16 CHAIRWOMAN SHOWALTER: Thank you.

17 JUDGE MOSS: All right, I suppose there
18 should be an opportunity for redirect, though I'm not
19 encouraging it.

20 MR. MEYER: And I can read your lips. I have
21 none.

22 JUDGE MOSS: All right, Mr. Eliassen, thank
23 you very much for your testimony this evening.

24 THE WITNESS: Thank you.

25 JUDGE MOSS: I will release you from the

00760

1 stand.

2 I believe that concludes the presentation of
3 witnesses. We do have the remaining matter of business
4 concerning the briefing, which I have left tentative. I
5 was informed during the break that despite the request
6 by the company and others to have an expedited
7 transcript, that in light of the late hour which we have
8 run this evening, it will not be possible to have the
9 transcript on Monday as hoped for, but that they could
10 be assured, reasonable assurance could be provided that
11 they would be produced by noon on Tuesday. Ms. Kinn, is
12 that -- could you give me a nod in the affirmative if I
13 got that right.

14 I may have misrepresented what you told me.
15 I probably did given the late hour.

16 Let's go off the record.

17 (Discussion off the record.)

18 JUDGE MOSS: It appears that we can make this
19 work by hook or crook, and so why don't we set the 17th
20 as the day for briefs. And let me emphasize what is our
21 standing requirement, if you will, that you all submit
22 those in addition to submitting paper copies in a timely
23 fashion, that you get those briefs to us electronically,
24 because that does help us to process things.

25 So with that emphasis, briefs will be due on

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1 the 17th of September, and the Commission will move with
2 its usual deliberate speed to bring the matter to an
3 expeditious conclusion.

4 Is there any other procedural matter that we
5 need to discuss?

6 Mr. ffitch.

7 MR. FFITCH: Your Honor, Public Counsel has a
8 Record Requisition Number 30, and I wanted to just
9 establish a response date.

10 JUDGE MOSS: That was the data concerning
11 Avista's budget cuts.

12 MR. FFITCH: Right.

13 JUDGE MOSS: What's the response date on
14 that, Mr. Meyer?

15 MR. MEYER: How about Monday?

16 MR. FFITCH: I don't know, that's an awfully
17 long delay.

18 MR. MEYER: How about Monday?

19 MR. FFITCH: Monday will be fine.

20 MR. MEYER: We will work for Monday.

21 MR. FFITCH: Thank you very much.

22 JUDGE MOSS: All right, anything else we need
23 to consider?

24 Thank you all very much. We look forward to
25 receiving the briefs. And I would like to compliment

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1 all counsel on the very fine job they did in this
2 proceeding and acknowledge as well the witnesses'
3 efforts on our behalf.

4 (Hearing adjourned at 9:15 p.m.)

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